

Agenda Item:

# Pension Fund Committee

7

**Dorset County Council**


Date of Meeting	3 March 2015
Officer	Chief Financial Officer
<b>Subject of Report</b>	<b>Fund Administrator’s Report</b>
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 third quarter of the 2014/15 Financial Year to 31 December 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 7.50% over the nine months to 31 December, outperforming its benchmark which returned 6.68%. Return seeking assets added 7.68%, whilst the liability matching assets returned 5.75%. For the same period the WM Local Authority average returned 7.3%.</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"> <li>i) Review and comment upon the activity and overall performance of the Fund.</li> <li>ii) Make no asset allocation changes at this time.</li> </ul>
<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 nine months to 31 December 2014 Appendix 4: Member Training</p>
<p>Background Papers</p>	<p>HSBC Performance Statistics</p>
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## 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 and 2015/16 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 nine months under review.

	<u>£M</u>	<u>£M</u>
<b>Cash at 1st April 2014</b>		<b>116.3</b>
<b>Less:</b>		
Property Transactions (net)	19.1	
Private Equity drawdowns (net)	0.1	
UK Equity purchases (net)	26.3	
Barings - additional investment	10.0	
Insight - additional investment	50.0	
RLAM - additional investment	50.5	
Infrastructure drawdowns	26.9	
Currency Hedge Loss	6.2	
Transfer of Probation Service to Gtr Manchester PF	34.4	
		<b>223.5</b>
<b>Plus:</b>		
Hedge Fund redemptions	75.7	
Lump sum contributions 2015/16 & 2016/17*	32.7	
Net New Money	36.0	
		<b>144.4</b>
<b>Cash at 31 December 2014</b>		<b>37.2</b>

*\*£49M received as upfront payments in 2014/15 of which two thirds relates to future years, 2015/16 and 2016/17.*

- 2.2 The cash flow above shows the most significant transactions that have taken place this financial year up to the end of December 2014. The Net New Money of £36M for the year to 31 December indicates that it is likely the Fund will have a surplus greater than the £36.8M predicted by the end of the year.
- 2.3 The most significant transactions that have taken place since 31 December were the £10M sale of the Inprop property fund held by CBREi, £4M redemption of IAM and a £15M payment to Insight for the increased allocation agreed at the September meeting.
- 2.4 As a result of this and other transactions, including monthly payments to pensioners and contributions from employers, the Fund’s cash balances as at the start of February 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 over the course of the year and the position will continue to be monitored.

### 3. Fund Portfolio Distribution

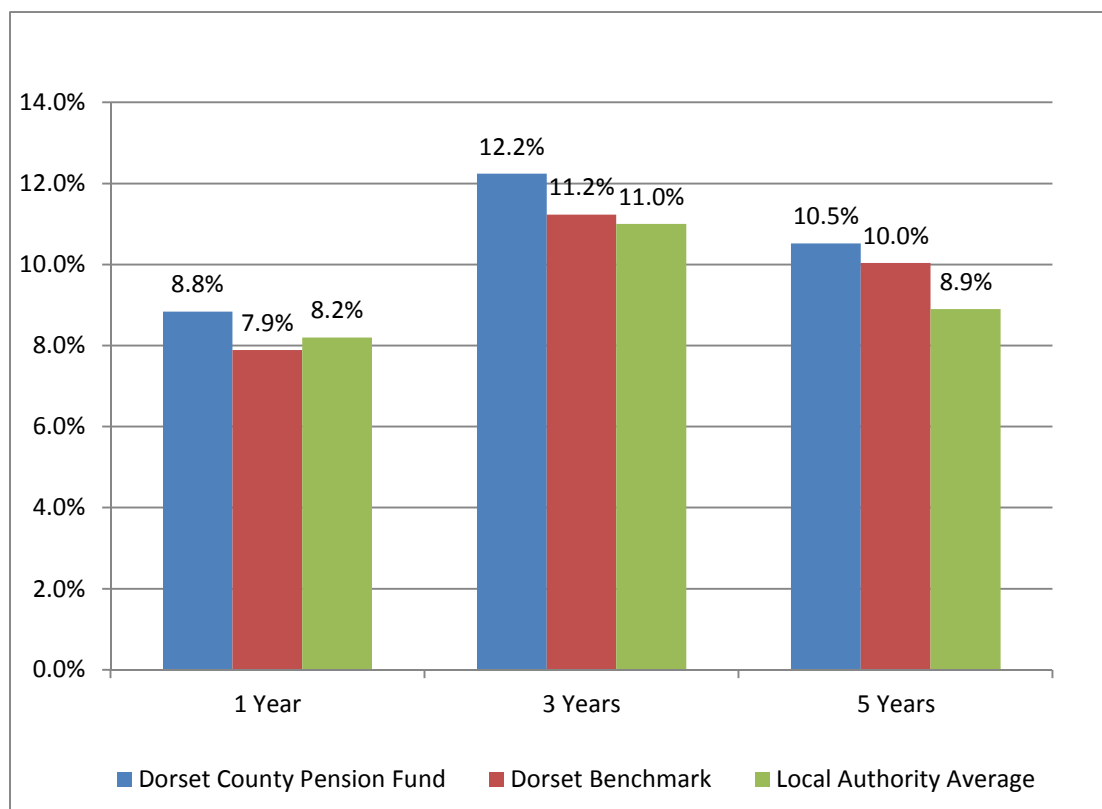
- 3.1 Members will be aware of the changes made to the Fund’s strategy at recent meetings, and therefore, the benchmark against which the asset allocation is currently measured is somewhat a “work in progress”. The table below shows the position as at 31 December 2014, and the target allocation shown is as agreed at the September meeting of the committee.

<b>Asset Class</b>	<b>Manager</b>	<b>01 April 2014</b>		<b>31-Dec-14</b>		<b>Target Allocation</b>	
		<b>£M</b>	<b>%</b>	<b>£M</b>	<b>%</b>	<b>£M</b>	<b>%</b>
Bonds	(Several)	396.8	19.1%	538.1	24.1%	546.5	24.5%
UK Equities	(Several)	580.7	27.9%	600.4	26.9%	613.4	27.5%
Overseas Equities	(Several)	562.7	27.0%	619.3	27.8%	557.7	25.0%
Property	(CBREi)	187.1	9.0%	227.3	10.2%	223.1	10.0%
Absolute Return Funds	(Several)	90.2	4.3%	12.9	0.6%	-	0.0%
Infrastructure	(Several)	-	0.0%	26.9	1.2%	89.2	4.0%
Private Equity	(Several)	53.2	2.6%	61.2	2.7%	89.2	4.0%
Diversified Growth	(Barings)	92.7	4.5%	107.5	4.8%	111.5	5.0%
Cash	(Internal)	117.2	5.6%	37.2	1.7%	-	0.0%
<b>Total</b>		<b>2,080.7</b>	<b>100.0%</b>	<b>2,230.7</b>	<b>100.0%</b>	<b>2,230.7</b>	<b>100.0%</b>

- 3.2 The table above shows that in most asset classes the Fund’s allocation is now close to or slightly above target, with the exception of Private Equity and Infrastructure which will take a number of months to fully drawdown. Overseas Equities are currently above target but this will be addressed as a result of the review to be considered as a separate agenda item by this committee. It is also interesting to note that Property has now reached its target allocation largely as a result of the following purchases in the year - Pilgrim House, Aberdeen (£10M), Ebenezer Street, London (£6M), and Great Suffolk Street, London (£2M).

### 4. Overall Fund Performance

- 4.1 The performance of the Fund during the first three quarters shows an overall return of 7.50%, an outperformance of the benchmark of 6.68% by 0.82%. Over the last 12 month period the Fund has returned 8.79% against the benchmark of 7.89%, an outperformance of 0.90%.
- 4.2 The Fund has exceeded its benchmark over 3 years, returning an annualised 12.22% against the benchmark of 11.23%, and over 5 years, returning an annualised 10.51% against the benchmark of 10.04%.
- 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 12.35% since its inception on 1st July 2012. For the nine months to 31 December, Return Seeking assets have returned 7.68% against the benchmark of 7.11%. The Liability Matching assets have returned 5.75% against the benchmark of 2.80%. 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>9 Months to 31 Dec 2014</u>		
		<u>Dorset</u>	<u>Benchmark</u>	<u>Over/(Under)</u>
		<u>%</u>	<u>%</u>	<u>%</u>
<b>Overall Fund Performance</b>	<b>All</b>	<b>7.50</b>	<b>6.68</b>	<b>0.82</b>
<b>Total Return Seeking Assets</b>	<b>Various</b>	<b>7.68</b>	<b>7.11</b>	<b>0.57</b>
UK Equities	(Various)	0.93	1.64	-0.71
Overseas Equities	(Various)	11.24	10.81	0.43
Bonds	(RLAM)	12.39	12.33	0.06
Property	(CBREi)	15.92	13.75	2.17
Hedge Funds	(Various)	3.40	5.07	-1.67
Private Equity	(Various)	12.56	1.82	10.74
Diversified Growth	(Barings)	4.86	3.42	1.44
<b>Total Liability Matching Assets</b>		<b>5.75</b>	<b>2.80</b>	<b>2.95</b>
Bonds	(Insight)	5.75	2.80	2.95

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 5 and 6. This analysis shows that the market contribution had a positive effect of 18bps against the benchmark and stock selection was positive by 35bps. Return seeking assets had an overall positive contribution of 46bps mainly driven by private equity (32bps) and property (15bps). The stock selection contribution on return seeking assets was hit by equities, which had a negative contribution of 38bps, offset by positive contributions from property (20bps) and private equity (21bps). In all other areas contributions were broadly neutral.

## 5. Manager Progress (excluding UK equities)

### Diversified Growth

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 nine months to 31 December 2014 is summarised below.

	Market Value at 1 April 2014	Market Value at 31 Dec 2014	9 months to 31 Dec 2014		12 months to 31 Dec 2014	
	£000s	£000s	Performance %	Benchmark %	Performance %	Benchmark %
Barings	92,715	107,534	4.86	3.42	4.32	4.57

5.3 Over the quarter the Fund delivered a 2.7% positive return, against the benchmark of 1.1%. The best performing asset class during the quarter was bonds, with commercial property also having a strong quarter. Emerging Market equities suffered another weak period due to the on-going conflict between Russia and Ukraine, and the decline in commodity prices, particularly oil.

Active US Equity

5.4 The performance of Intech is summarised below.

	Market Value		Performance	Benchmark
	01-Apr-14	31-Dec-14	%	%
USD \$000s	185,004	209,621	13.31	11.67
GBP £000s	110,967	134,433	21.15	19.40

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 three quarters the fund made a positive return of 21.15%, against the benchmark of 19.40%. Over the past three years to 31 December 2014, the fund has returned an annualised 20.65% against the benchmark (S&P 500) return of 20.28%. Over five years the fund has returned 17.12% per annum against the benchmark of 16.27%.

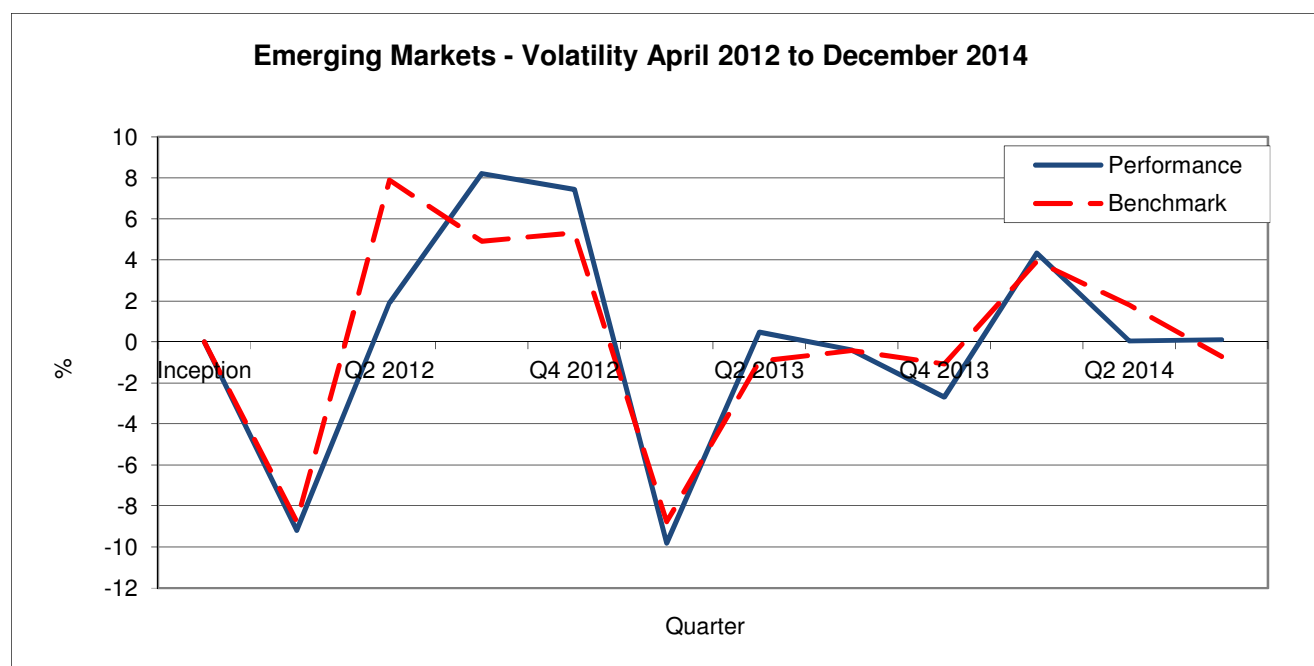
Emerging Market Equity

5.6 The JP Morgan mandate commenced on 5<sup>th</sup> April 2012. The performance of the investment is shown below.

	Value at 1 April 2014	Market Value at 31 Dec 2014	9 months to 31 Dec 2014		12 months to 31 Dec 2014	
	(£000's)	(£000's)	Performance %	Benchmark %	Performance %	Benchmark %
JP Morgan	63,528	66,392	4.51	5.03	1.70	3.90

5.7 The return of 4.51% for the first three quarters was below the benchmark by 0.52% and the annual return is now 1.7% below the benchmark by 2.2%. The fund manager comments that emerging markets have had a difficult and volatile calendar year driven by external shocks (the US dollar strength and the collapse in the oil price and internal issues (Russia’ conflict with Ukraine and political instability in Brazil).

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 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 31 December 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 31 December 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	11.160	93%	6.964	8.473	4.277
HV Direct V	3.000	2.880	96%	1.514	2.015	0.649
SL 2006	22.000	19.261	88%	9.394	14.205	4.338
SL 2008	17.000	11.478	68%	2.070	11.671	2.263
	<u>\$m</u>	<u>\$m</u>		<u>\$m</u>	<u>\$m</u>	<u>\$m</u>
HV Venture VIII	15.200	14.364	95%	7.936	14.779	8.351
HV Buyout VIII	22.800	19.950	88%	11.219	17.376	8.645
HV Buyout IX	15.000	4.650	31%	0.509	4.937	0.796
HV Venture IX	10.000	5.050	51%	0.701	5.832	1.483
SL SOF I	16.000	6.027	38%	0.000	6.317	0.290
SL SOF II	20.000	2.173	11%	0.000	2.175	0.002

- 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.

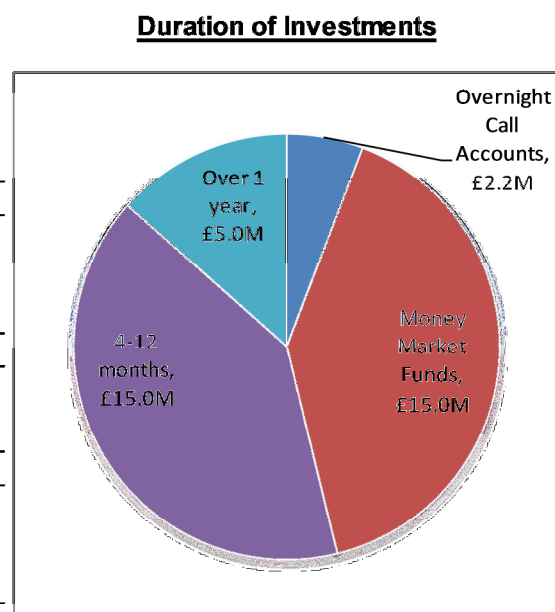
**Private Equity Overall Performance**

<u>Manager</u>	<u>3 Years to 31 Dec 2014</u>		<u>5 Years to 31 Dec</u>	
	<u>Dorset</u>	<u>Benchmark</u>	<u>Dorset</u>	<u>Benchmark</u>
	<u>%</u>	<u>%</u>	<u>%</u>	<u>%</u>
HarbourVest	15.16	11.13	15.24	8.70
Standard Life	11.93	11.13	14.04	8.70

**6. Treasury Management**

- 6.1 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 31 December 2014 is shown in the table below. Additional cash balances are also held tactically by Pictet within their overseas equity portfolio, and there are relatively small amounts 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.
- 6.2 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 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.
- 6.3 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 0.44% over the nine months, which is ahead of the benchmark, as measured by the 7 day LIBID, at 0.27%. Over the twelve months to 31 December 2014 the Fund has achieved 0.67% against the benchmark of 0.35%. 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>
<b><u>Fixed Term Deposits</u></b>		
Lloyds Banking Group	5,000	1.00%
Barclays Bank Plc	15,000	0.61%
<b>Total Loans</b>	<b>20,000</b>	<b>0.71%</b>
<b><u>Call Accounts</u></b>		
National Westminster Bank	183	0.25%
Svenska Handelsbanken	700	0.45%
<b>Total Call Accounts</b>	<b>883</b>	<b>0.41%</b>
<b><u>Money Market Funds</u></b>		
Ignis	15,000	0.48%
<b>Total Money Market Funds</b>	<b>15,000</b>	<b>0.48%</b>
<b><u>Holding Accounts</u></b>		
HSBC Custodian Account	124	0.01%
Property Client Account	1,148	0.01%
<b>Total Holding Accounts</b>	<b>1,272</b>	<b>0.01%</b>
<b>Total Cash / Average Return</b>	<b>37,155</b>	<b>0.58%</b>



6.4 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.

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

Short term: F1  
Long term: A-

6.6 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.

6.7 The annual Treasury Management Strategy for 2015/16 is to be considered as a separate agenda item by this committee.

## 7. **Asset Allocation**

7.1 A separate report is on the agenda for this meeting that covers the review of the overseas equity portfolio, and so this area will not be discussed here, but it could mean some asset allocation changes in the future.

7.2 In addressing the under allocation in Private Equity officers are in on-going discussions with the Fund’s appointed managers; SL Capital and HarbourVest to identify further opportunities. These discussions are in line with the Fund’s previously agreed the policy of allocating £50 Million over 2 years starting in June 2014. The Committee will be updated on any progress in this area.

7.3 On 16 February the Officers and adviser met with Insight investment to discuss recent movements in the pricing of inflation protection, and the impact this was having on the Dorset investment. The discussion focussed around the remaining trigger levels and whether they should be moved. It was proposed to reduce the

remaining trigger levels, and Insight would look at the impact this would have and report back before the final decision was made. This information is not available at the time of writing, but it is hoped it will be available to update the Committee verbally at the meeting.

7.4 There is no additional recommended change to the Fund’s asset allocation at this time.

## **8. Update of Local Pension Board**

8.1 At the November meeting of the Pension Fund Committee the draft terms of reference for the new Local Board for the Dorset County Pension Fund. The terms of reference were subsequently approved by the County Council’s Standards and Governance Committee in January 2015 and then by the County Council on 12 February 2015.

8.2 In late January the DCLG issued the final regulations that governed local boards and whilst they included some minor changes from the draft regulations there was nothing of significance that affected the Dorset terms of reference.

8.3 A process will now commence to recruit the 3 Employer representatives, and 3 Employee representatives that will sit on the Board. Members will recall that whilst the Board needs to be constituted by 1 April 2015, funds have up to four months for the first meeting. It is planned that the first meeting of the Dorset Board will be at 2.00pm on the 24 June; the afternoon of the next meeting of Pension Fund Committee. The Fund’s Governance adviser Peter Scales will attend both meetings on the day, and will help the Board with training, and setting its agenda. National training will also be available to Board members, and this will be offered as part of the recruitment process.

8.4 The officers, led by the Fund Administrator will manage the recruitment process, and appointments will be made in consultation with this Committee. Due to this Committee not meeting until June, this process and all correspondence will be by email.

## **9. Committee member training**

9.1 Members will recall that the Fund recognises the importance of ensuring that all officers and members of the Pension Fund Committee are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them. To enable this, the Fund arranges training and educational events, and has adopted a Training Policy.

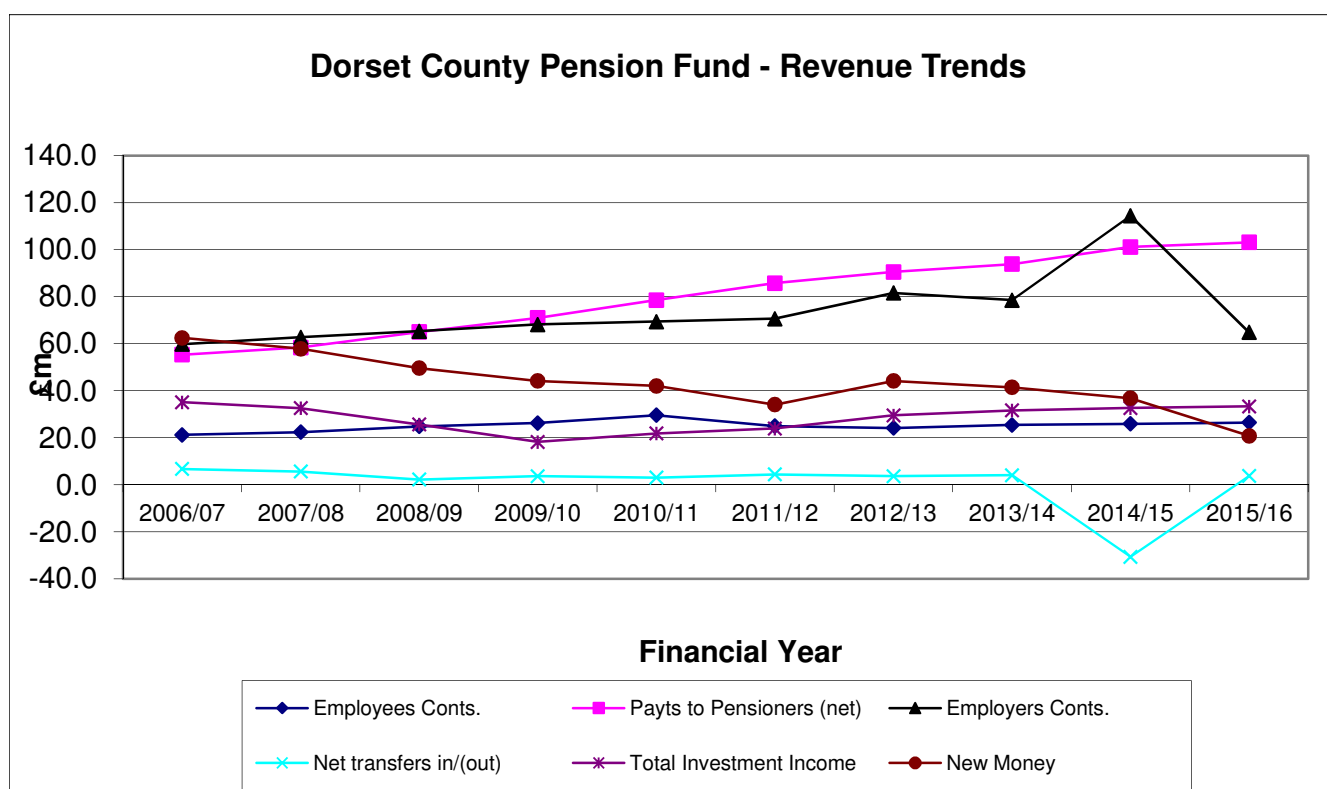
9.2 As part of the training policy the member training log is regularly reported to the Committee, and any specific training opportunities that have been identified as appropriate. Attached to this report at Appendix 4 is the up to date training log, and a list of some of the training opportunities that are available. This is by no means an exhaustive list, and should other opportunities arise during the year, officer will highlight them to members.

## Appendix 1

### BUDGET MONITORING

	Actual 2013/14	Estimate 2014/15	Estimate 2015/16
	£'000	£'000	£'000
<b>INCOME:</b>			
Employers' Contributions	78,474	114,400	64,800
Employees' Contributions	25,412	25,900	26,400
Transfer Values (net)	3,961	3,700	3,700
Investment Income	31,649	32,600	33,300
<b>TOTAL INCOME:</b>	<b>139,496</b>	<b>176,600</b>	<b>128,200</b>
<b>EXPENDITURE:</b>			
Net Management Expenses	4,278	4,300	4,300
Payments to Pensioners (net)	93,803	101,100	103,100
Transfer of Probation Service to Gtr Manchester		34,400	0
<b>TOTAL EXPENDITURE:</b>	<b>98,081</b>	<b>139,800</b>	<b>107,400</b>
<b>NET NEW MONEY FOR THE YEAR</b>	<b>41,415</b>	<b>36,800</b>	<b>20,800</b>

### REVENUE TRENDS & FORECASTS



REPORT OF THE INVESTMENT ADVISER  
PREPARED FOR

**Dorset County Pension Fund**

**Pension Fund Committee**

**On March 3<sup>rd</sup> 2015**

**Investment Outlook**

**Alan Saunders**

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## Dorset County Council Pension Fund

March 2015

### Report of the Investment Adviser

#### Investment Outlook

At the last meeting, equities were undergoing a correction while the gilt market was rallying, helped by growing evidence of lower inflation fuelled by falling oil prices. We suggested there was no reason for the equity correction to become anything more serious and indeed markets generally have staged a strong recovery. Meanwhile gilt yields have continued to fall back to the levels of 2012 while oil prices have fallen all the way down to \$50/bbl. It would be fair to say that both were totally unexpected developments.

Last year proved a very mixed bag for UK pension funds. Best performing assets were gilts, especially long duration, commercial property and US equities. UK equities cut a sorry figure with a 1% return in contrast to global equities, led by the US. Looking forward, the current momentum in equities may well continue but while it may be reasonable to expect positive returns for the year we should also expect more volatility. Property should have one last good year before the property market cycle turns down while gilts and corporate bonds should bring up the rear, the extent of which depends on whether yields start to rise or stay low in a low inflation environment.

#### **Economy**

Both the UK and US economies produced softer Q4 GNP data so that the UK failed to deliver the 3% growth we had expected. Globally, the fall in oil prices is estimated to add some 0.5% to GNP growth this year and the UK is expected to grow some 2.5% again. The US should do better while Europe and Japan are expected to grow some 1.5%, a modest improvement.

The big stories apart from falling oil prices have been the ECB's long awaited introduction of QE and the election of a Greek government determined to renegotiate its debt bailout agreement. The ECB's move was even larger than forecast and has succeeded in weakening the euro still further. This may be the main stimulus from the move as there are doubts over the transmission process in Europe given that credit creation takes place through the banks rather than capital markets unlike the US. The possibility of "Grexit" or Greek exit is a new risk for markets which is not priced in but is still thought low probability and one that is a containable situation if it happened. Either way, the route to recovery in Europe looks protracted.

In the UK, markets seem somewhat insouciant about the prospects for a hung parliament with a vast range of outcomes in terms of potential coalitions. The economic recovery story seems well supported with real wage earnings starting to come through and continuing growth in employment. The fall in inflation is extraordinary and a result of falling oil prices especially and even though the numbers will bottom out during the year, annual inflation will be 1% or less... The political debate has been about the rate of fiscal tightening after the election and what the end game will look like. Whatever the fiscal outturn, it seems more certain that monetary policy will stay easy for longer given the good inflation news and expectations of the first base rate rise are being put back into next year.

Elsewhere, emerging markets remain a mixed bunch with Asian economies doing fairly well still compared to the rest of the world and with oil and commodity producers clearly suffering.

Currency movements were very pronounced last year with competitive devaluations, often as a result of QE, the name of the game, to the increasing irritation of the US and China whose currencies remain strong. Both the euro and yen fell some 13% against the dollar for example and 7% against sterling which fell 6% in turn against the dollar. Hedging the first two would have been helpful but hedging the dollar cost money last year, in contrast to the year before.

## Markets

Last year, gilts produced a 14% return, index linked 18% and corporate bonds 12% against 1% for UK equities but 19% for commercial property. True UK equities lagged the rest of the world but this was not the result managers expected, rather a rerun of 2013 when equities outperformed gilts comfortably. Gilt yields have actually fallen below US Treasury yields while index linked yields are strongly negative. Corporate bond spreads narrowed in before widening out at year end. The UK equity underperformance to some extent reflected the high sectoral exposure to oil and resource stocks in the index whereas the US boomed on technology stocks like Apple.

Can mean reversion in gilt yields still happen? Most commentators think so but not back to the yield levels before the crash and not for some time. The good news is that nominal yields have fallen more than real yields so that implied inflation is falling at last and we have been able to hit some of our trigger points with our inflation hedging strategy. At last implied inflation is coming in below 3% on a forward basis, i.e. close to the BoE's policy rate of 2% for CPI, allowing for the wedge.

With such low yields from low risk assets like gilts, equities and property offer a yield advantage though that will not protect them when sentiment turns negative. It is something of a surprise that UK equities have picked up ahead of the election though the economic background is supportive. Valuation is still acceptable as is the case for Europe, Japan and emerging markets in contrast to the US where earnings are beginning to be hit by the strong dollar. The main support for equities therefore continues to be the excess liquidity flowing into risk assets and the likely postponement of monetary tightening has kept the momentum going. If the earnings cycle does not turn up eventually in the non US markets, then equities will drift back.

All in all though we can expect another year of moderate global equity gains with possibly a change of leadership from the US to Europe once we get past the Greek crisis or possibly from emerging markets, assuming the dollar does not rise any further.

## Property

Another very strong year across all sectors but it does now leave UK property looking overvalued against historical valuations on a yield basis. The good news is that the occupier market is picking up and rental growth is now positive. Most expectations are for high single digit returns this year which will compare well with other asset classes. However, this will be a good year to sell weaker stock or very overvalued stock before the cycle turns and liquidity starts to dry up. Next year yields may start to rise offset to some extent by rising rents. Pension funds are increasingly looking for real return mandates, i.e. inflation plus 3-4% rather than IPD

benchmark driven mandates. This has led to high value long lease properties being driven to low yield levels meaning that returns will be squeezed accordingly.

## **Alternatives**

Last year saw moderate returns from hedge fund of funds and slightly better ones from Diversified Growth managers, with typical returns in the former around 3-4% and 4-6% in the latter, either matching or somewhat exceeding their Libor plus benchmarks. Within hedge funds, macro funds are doing better at last, allegedly on the basis that markets are less policy influenced than previously. Given diverse outlooks for equities and bonds and the risk of a setback to risk assets at some stage, these investments continue to have useful diversifying features. We must expect they will underperform risk assets in strong markets but hopefully do well during the cycle.

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

## **Asset Allocation**

Last year, most pension fund deficits will have widened out considerably because of the fall in long gilt yields. The scheme is of course much less sensitive on this score than the typical scheme because our discount rate for valuing liabilities is not based on gilts. 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. A lively debate is taking place among LA schemes as to whether they should engage in LDI though at today's nominal interest rate levels, the timing does not look attractive.

**Alan Saunders Senior Adviser**

**Allenbridge Epic Investment Advisers**





**Dorset County Pension Fund Total**

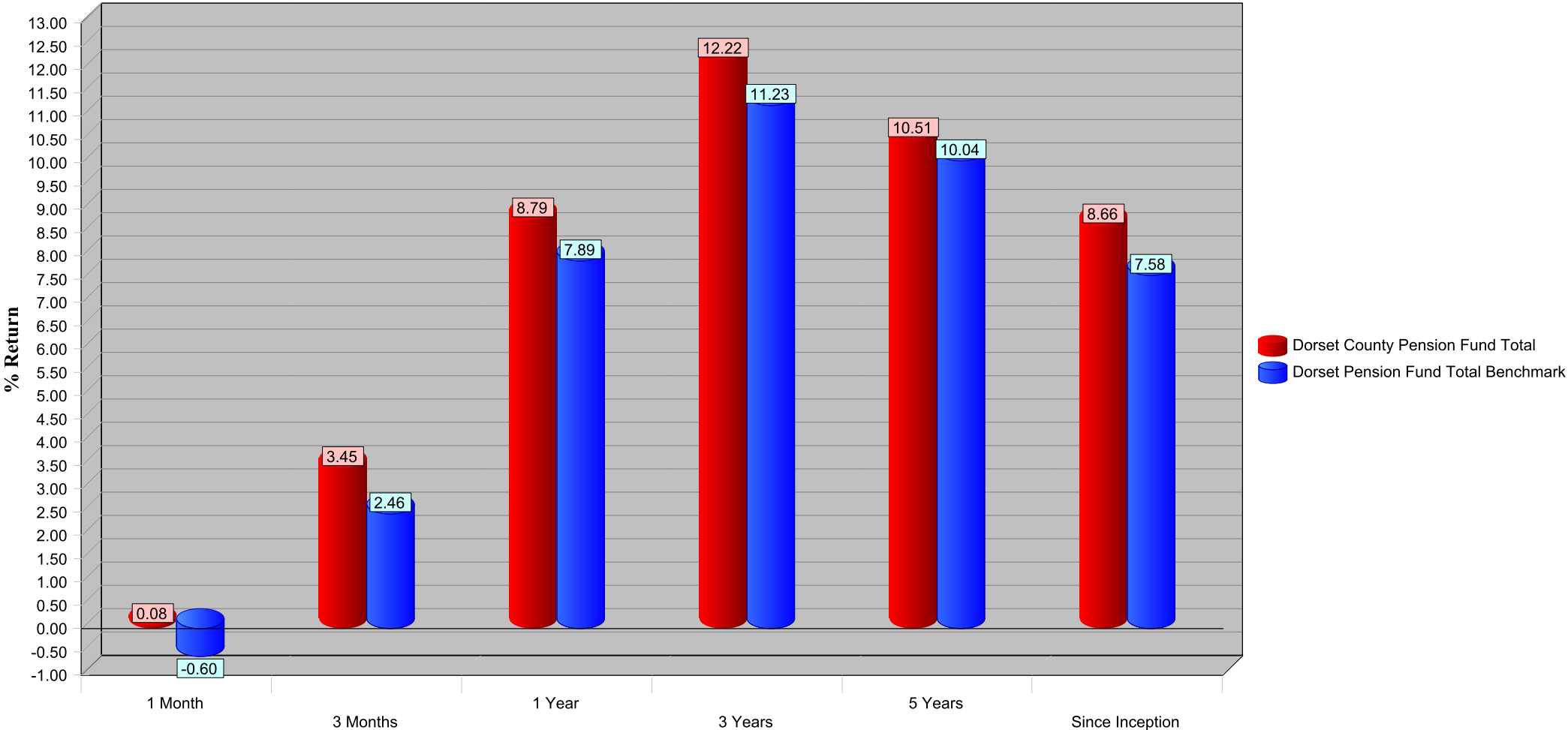
**01 Apr 2014 - 31 Dec 2014**

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 %
<b>Dorset County Pension Fund Total</b>	<b>2,080,695,680</b>	<b>100.00</b>	<b>16,711,510</b>	<b>133,305,678</b>	<b>2,230,712,867</b>	<b>100.00</b>	<b>24,860,716</b>	<b>7.50</b>	<b>6.68</b>
Dorset - AXA Framlington UK Equity	102,820,736	4.94	25,750	-46,902	102,799,584	4.61		-0.05	1.82
Dorset - Barings Asset Management	92,714,625	4.46	10000000	4,819,685	107,534,310	4.82		4.86	3.42
Dorset - CBRE Property	187,103,558	8.99	19,346,826	20,811,006	227,261,389	10.19	9,869,347	15.92	13.75
Dorset - Currency Hedging			-3,603,265	3,603,265		0.00		-463.79	
Dorset - Gottex Hedge Fund	32,340,874	1.55	-30,801,565	529,539	2,068,848	0.09		3.08	4.22
Dorset - HarbourVest Private Equity	32,461,796	1.56	-2,493,709	5,698,584	35,666,672	1.60		18.58	1.82
Dorset - Hermes Fund			26,858,965		26,858,965	1.20			
Dorset - IAM Hedge Fund	56,101,381	2.70	-47,726,067	644,047	9,019,361	0.40		-1.20	5.50
Dorset - Insight Fund	199,426,885	9.58	50003950.27	13,749,371	263,180,206	11.80	3950.27	5.75	2.80
Dorset - Internally Managed Cash	117,877,610	5.67	-80,722,873	-1	37,154,735	1.67	475,405	0.44	0.27
Dorset - Internally Managed UK Equity	365,643,358	17.57	25,655,136	-2,254,787	389,043,707	17.44	11,234,962	2.37	1.89
Dorset - JP Morgan	63,527,522	3.05		2,864,122	66,391,644	2.98		4.51	5.03
Dorset - Janus Intech US Equity Fund	110,966,854	5.33		23,465,903	134,432,756	6.03		21.15	19.40
Dorset - Pictet Global ex UK Equity	387,613,062	18.63	-3,488,077	34,378,420	418,503,406	18.76	2,755,813	9.67	10.14
Dorset - Pioneer Hedge Fund	1,800,440	0.09	-336421.9	308,206	1,772,224	0.08		21.33	5.01
Dorset - Royal London Bonds	197,328,985	9.48	50,791,868	26,800,170	274,921,023	12.32	521,238	12.39	12.33
Dorset - Schroders UK Equity	33,322,350	1.60	-123,898	-597,352	32,601,100	1.46		-1.79	-4.65
Dorset - Standard Life Private Equity	20,770,265	1.00	3,730,860	1,025,964	25,527,089	1.14		4.35	1.82
Dorset - Standard Life UK Equity	78,875,379	3.79	-405,970	-2,493,561	75,975,848	3.41		-3.17	1.82

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
<b>TOTAL ASSETS</b>	<b>2,080,695,680</b>	<b>16,711,510</b>	<b>2,230,712,867</b>	<b>133,305,678</b>	<b>24,860,716</b>	<b>7.50</b>
<b>Total Return Seeking Assets</b>	<b>1,881,268,795</b>	<b>-33,288,490</b>	<b>1,967,536,611</b>	<b>119,556,307</b>	<b>24,860,716</b>	<b>7.68</b>
Total Assets ex Hedging	1,881,268,795	-29,685,226	1,967,536,611	115,953,042	24,860,716	7.49
Total Equities	1,106,626,076	23,666,887	1,181,507,553	51,214,590	13,514,214	5.84
UK	580,661,824	25,151,017	600,420,238	-5,392,603	11,234,962	0.93
Dorset UK Internally Managed	365,643,358	25,655,136	389,043,707	-2,254,787	11,234,962	2.37
AXA Framlington UK Equity	102,820,736	25,750	102,799,584	-46,902		-0.05
Standard Life UK Equity Select Fund	78,875,379	-405,970	75,975,848	-2,493,561		-3.17
Schroders UK Small Cap Equity	33,322,350	-123,898	32,601,100	-597,352		-1.79
Overseas Equities	525,964,252	-1,484,130	581,087,315	56,607,192	2,279,252	11.24
North America	308,183,699	-16,316,032	345,986,116	54,118,450	759,001	18.22
Pictet North America	197,216,845	-16,316,032	211,553,360	30,652,547	759,001	16.50
Janus Intech US Equity	110,966,854		134,432,756	23,465,903		21.15
Europe ex UK	94,783,778	3,578,506	92,333,466	-6,028,819	1,373,672	-4.89
Pictet Europe ex UK	94,783,778	3,578,506	92,333,466	-6,028,819	1,373,672	-4.89
Japan	41,593,381	6,125,235	52,403,350	4,684,735	31,682	10.29
Pictet Japan Equity	41,593,381	6,125,235	52,403,350	4,684,735	31,682	10.29
Pacific ex Japan	17,875,872	5,128,162	23,972,738	968,704	114,897	11.06
Pictet Pacific ex Japan	17,875,872	5,128,162	23,972,738	968,704	114,897	11.06
Emerging Markets	63,527,522		66,391,644	2,864,122		4.51
JP Morgan Global Emerging Markets	63,527,522		66,391,644	2,864,122		4.51
Total Bonds	197,328,985	50,791,868	274,921,023	26,800,170	521,238	12.39
Royal London Bonds	197,328,985	50,791,868	274,921,023	26,800,170	521,238	12.39
Total Property	187,103,558	19,346,826	227,261,389	20,811,006	9,869,347	15.92
ING Property	187,103,558	19,346,826	227,261,389	20,811,006	9,869,347	15.92
Total Cash	154,020,795	-82,722,869	75,399,177	4,101,252	955,917	3.44
Total Hedge Funds	90,242,696	-78,864,053	12,860,434	1,481,791		3.40
Gottex Hedge Fund	32,340,874	-30,801,565	2,068,848	529,539		3.08
Pioneer Hedge Fund	1,800,440	-336,422	1,772,224	308,206		21.33
IAM (Hedged)	56,101,381	-47,726,067	9,019,361	644,047		-1.20

## Gain/Loss Analysis

Category	Initial Market Value	Net Investment	Final Market Value	Capital Gain/Loss	Income	% Return
IAM Hedge Fund	56,101,381	-47,701,225	9,019,361	619,205		7.39
Currency Hedging (IAM)		-24,842		24,842		-96.55
Private Equity	53,232,061	1,237,151	61,193,760	6,724,549		12.56
HarbourVest	32,461,796	-2,493,709	35,666,672	5,698,584		18.58
Standard Life Private Equity	20,770,265	3,730,860	25,527,089	1,025,964		4.35
Diversified Growth Fund	92,714,625	10,000,000	107,534,310	4,819,685		4.86
Baring Dynamic Asset Allocation Fund	92,714,625	10,000,000	107,534,310	4,819,685		4.86
Infrastructure		26,858,965	26,858,965	0		-0.00
Hermes		26,858,965	26,858,965	0		-0.00
Total Currency Hedging	0	-3,603,265	0	3,603,265		-463.79
<b>Total Matching Assets</b>	<b>199,426,885</b>	<b>50,000,000</b>	<b>263,176,256</b>	<b>13,749,371</b>		<b>5.75</b>
Insight Liability Fund	199,426,885	50,000,000	263,176,256	13,749,371		5.75

All periods > 1 year represent actual values.

## Asset Allocation

Category	Initial Market %		Final Market %		Local Currency % Return		Base Currency % Return	
	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark
<b>TOTAL ASSETS</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>6.86</b>	<b>6.29</b>	<b>7.50</b>	<b>6.68</b>
<b>Total Return Seeking Assets</b>	<b>90.42</b>	<b>90.00</b>	<b>88.20</b>	<b>90.00</b>	<b>6.94</b>	<b>6.67</b>	<b>7.68</b>	<b>7.11</b>
Total Assets ex Hedging	90.42	90.00	88.20	90.00	6.75	6.67	7.49	7.11
Total Equities	53.19	55.00	52.97	55.00	4.69	5.23	5.84	5.92
UK	27.91	29.00	26.92	29.00	0.93	1.64	0.93	1.64
Dorset UK Internally Managed	17.57	20.00	17.44	20.00	2.37	1.89	2.37	1.89
AXA Framlington UK Equity	4.94	4.00	4.61	4.00	-0.05	1.82	-0.05	1.82
Standard Life UK Equity Select Fund	3.79	4.00	3.41	4.00	-3.17	1.82	-3.17	1.82
Schroders UK Small Cap Equity	1.60	1.00	1.46	1.00	-1.79	-4.65	-1.79	-4.65
Overseas Equities	25.28	26.00	26.05	26.00	8.84	9.31	11.24	10.81
North America	14.81	13.65	15.51	13.65	10.79	11.12	18.22	18.55
Pictet North America	9.48	9.65	9.48	9.65	9.30	10.90	16.50	18.19
Janus Intech US Equity	5.33	4.00	6.03	4.00	13.31	11.67	21.15	19.40
Europe ex UK	4.56	5.35	4.14	5.35	0.98	3.76	-4.89	-2.87
Pictet Europe ex UK	4.56	5.35	4.14	5.35	0.98	3.76	-4.89	-2.87
Japan	2.00	2.10	2.35	2.10	19.87	18.57	10.29	8.90
Pictet Japan Equity	2.00	2.10	2.35	2.10	19.87	18.57	10.29	8.90
Pacific ex Japan	0.86	1.10	1.07	1.10	4.69	6.26	11.06	8.19
Pictet Pacific ex Japan	0.86	1.10	1.07	1.10	4.69	6.26	11.06	8.19
Emerging Markets	3.05	3.80	2.98	3.80	4.51	6.06	4.51	5.36
JP Morgan Global Emerging Markets	3.05	3.80	2.98	3.80	4.51	6.06	4.51	5.36
Total Bonds	9.48	10.00	12.32	10.00	12.39	12.33	12.39	12.33
Royal London Bonds	9.48	10.00	12.32	10.00	12.39	12.33	12.39	12.33
Total Property	8.99	10.00	10.19	10.00	15.92	13.75	15.92	13.75
ING Property	8.99	10.00	10.19	10.00	15.92	13.75	15.92	13.75
Total Cash	7.40		3.38		3.44		3.44	
Total Hedge Funds	4.34	6.00	0.58	6.00	3.05	5.07	3.40	5.07
Gottex Hedge Fund	1.55	2.00	0.09	2.00	3.08	4.22	3.08	4.22
Pioneer Hedge Fund	0.09		0.08		13.47	5.01	21.33	5.01
IAM (Hedged)	2.70	4.00	0.40	4.00	-1.20	5.50	-1.20	5.50

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	0.40	4.00	7.39	5.50	7.39	5.50
Currency Hedging (IAM)							-96.55	
Private Equity	2.56	4.00	2.74	4.00	10.48	1.82	12.56	1.82
HarbourVest	1.56	2.00	1.60	2.00	14.70	1.82	18.58	1.82
Standard Life Private Equity	1.00	2.00	1.14	2.00	4.35	1.82	4.35	1.82
Diversified Growth Fund	4.46	5.00	4.82	5.00	4.86	3.42	4.86	3.42
Baring Dynamic Asset Allocation Fund	4.46	5.00	4.82	5.00	4.86	3.42	4.86	3.42
Infrastructure			1.20		-0.00		-0.00	
Hermes			1.20		-0.00		-0.00	
Total Currency Hedging	0.00		0.00		-463.79		-463.79	
<b>Total Matching Assets</b>	<b>9.58</b>	<b>10.00</b>	<b>11.80</b>	<b>10.00</b>	<b>5.75</b>	<b>2.80</b>	<b>5.75</b>	<b>2.80</b>
Insight Liability Fund	9.58	10.00	11.80	10.00	5.75	2.80	5.75	2.80

All periods > 1 year represent actual values.

## Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
<b>TOTAL ASSETS</b>	<b>0.24</b>	<b>0.18</b>	<b>0.35</b>	<b>0.77</b>
<b>Total Return Seeking Assets</b>	<b>0.25</b>	<b>0.18</b>	<b>0.02</b>	<b>0.46</b>
Total Assets ex Hedging	0.25	0.02	0.02	0.29
Total Equities	0.21	0.14	-0.38	-0.03
UK	0.02	0.06	-0.16	-0.09
Dorset UK Internally Managed	0.02	0.12	0.08	0.22
AXA Framlington UK Equity	-0.00	-0.03	-0.10	-0.13
Standard Life UK Equity Select Fund	0.00	0.02	-0.18	-0.16
Schroders UK Small Cap Equity	-0.00	-0.06	0.04	-0.02
Overseas Equities	0.19	0.08	-0.21	0.06
North America	0.07	0.06	-0.05	0.08
Pictet North America	-0.03	-0.01	-0.14	-0.18
Janus Intech US Equity	0.10	0.07	0.08	0.26
Europe ex UK	0.09	0.02	-0.12	-0.02
Pictet Europe ex UK	0.09	0.02	-0.12	-0.02
Japan	-0.01	0.02	0.02	0.03
Pictet Japan Equity	-0.01	0.02	0.02	0.03
Pacific ex Japan	0.02	-0.01	-0.02	-0.01
Pictet Pacific ex Japan	0.02	-0.01	-0.02	-0.01
Emerging Markets	0.02	-0.00	-0.04	-0.02
JP Morgan Global Emerging Markets	0.02	-0.00	-0.04	-0.02
Total Bonds	-0.01	0.06	0.00	0.06
Royal London Bonds	-0.01	0.06	0.00	0.06
Total Property	0.00	-0.05	0.20	0.15
ING Property	0.00	-0.05	0.20	0.15
Total Cash	-0.03	-0.22		-0.25
Total Hedge Funds	0.03	0.02	-0.07	-0.02
Gottex Hedge Fund	0.00	0.01	-0.03	-0.02
Pioneer Hedge Fund	0.00	0.00		0.01



Relative Attribution

Category	Currency Contribution	Market Contribution	Selection Contribution	Total Contribution
IAM (Hedged)	0.02	0.01	-0.04	-0.01
IAM Hedge Fund	0.02	0.01	-0.04	-0.02
Currency Hedging (IAM)	0.00	0.00		0.00
Private Equity	0.05	0.06	0.21	0.32
HarbourVest	0.05	0.02	0.18	0.25
Standard Life Private Equity	0.00	0.04	0.03	0.07
Diversified Growth Fund	-0.00	0.01	0.06	0.07
Baring Dynamic Asset Allocation Fund	-0.00	0.01	0.06	0.07
Infrastructure	0.00	-0.01		-0.01
Hermes	0.00	-0.01		-0.01
Total Currency Hedging	0.00	0.16		0.17
<b>Total Matching Assets</b>	<b>-0.01</b>	<b>-0.00</b>	<b>0.33</b>	<b>0.31</b>
Insight Liability Fund	-0.01	-0.00	0.33	0.31

All periods > 1 year represent actual values.

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Hedge Fund Research

Source: Hedge Fund Research, Inc. - [www.hedgefundresearch.com](http://www.hedgefundresearch.com)

IPD

This portfolio has not been independently validated by IPD.

Pension Fund Committee

APPENDIX 4

Member Training Log

<u>Date</u>	<u>Event</u>	<u>Duration (Days)</u>	<u>Member Attendance</u>								
			John Beesley	John Lofts	Neil Sorton	Johnny Stephens	Mike Lovell	Ron Coatsworth	Mike Byatt	Andy Canning	Colin Jamieson
<b>2013</b>											
18 February 2013	Chairmans Briefing	0.25			✓						
22-23 May 2013	NAPF Local Authority conference	1.50	✓		✓						
12 June 2013	New members induction/briefing	0.50			✓	✓			✓	✓	
12 June 2013	Chairmans Briefing	0.25			✓						
03 September 2013	Chairmans Briefing	0.25			✓						
5-6 September 2013	LGC Investment Conference	1.50	✓								
19 September 2013	AXA IM Elected members training day	1.00							✓		
23 October 2013	Local Gov. Pensions Investment Forum	1.00							✓		
15 November 2013	Chairmans Briefing	0.25			✓						
20 November 2013	UK Equity investing - AXA IM, Global Equity investing and Custody - Pictet	1.00	✓		✓	✓	✓	✓	✓	✓	✓
27 November 2013	Annual Employers Meeting	0.50		✓			✓				
05 December 2013	LAPFF Conference	1.00	✓								
	<b>2013 Total</b>		5	0.5	3.5	1.5	1.5	1	3.5	1.5	1
<b>2014</b>											
19 February 2014	330 Consulting - Committee training	1.00				✓					✓
03 March 2014	Chairmans Briefing	0.25			✓						
04 March 2014	JLT - Setting Investment Strategy and Infrastructure investing	0.50	✓	✓	✓	✓	✓	✓	✓	✓	✓
20-21 May 2014	NAPF LA Conference	1.50	✓		✓						
19 June 2014	LGPC Conference - Bournemouth	1.00							✓		
23 June 2014	Chairmans Briefing	0.25			✓						
25 June 2014	Private Equity Investing - HarbourVest/ SL Capital, Inflation Hedging - Insight	1.00	✓	✓	✓	✓	✓	✓	✓	✓	✓
02 September 2014	Chairmans Briefing	0.25			✓						
9-10 September 2014	LGC Investment Conference	1.50	✓								
25 November 2014	Chairmans Briefing	0.25	✓								
26 November 2014	Property Investing - CBREi, Corporate Bond investing - rlam	1.00	✓	✓			✓	✓	✓	✓	✓
02 December 2014	Annual Employers Meeting	0.50									
4-5 December 2014	LAPFF Annual Conference	1.50	✓								
	<b>2014 Total</b>		7.25	2.5	3.75	2.5	2.5	2.5	3.5	2.5	3.5
<b>2015</b>											
25 February 2015	Chairman's briefing	0.25	✓								

 = not a Committee member at this time

## **Pension Fund Committee Training Opportunities - 2015**

### **Conferences**

SPS Local Authority Pension Fund Investment Issues	London	19 March
NAPF Local Authority Conference	Four Pillars Hotel, Cotswolds	18-19 May
LGPC Conference	Cardif	25-26 June
LGC Investment Summit	Celtic Manor, Newport	10-11 September
Local Government Pension Investment Forum	London	TBC - October
LAPFF Annual Conference	Bournemouth	TBC December

### **Information on all external conferences and training available from officers**

### **Training on Specific Issues/with Specific Managers**

Linked to Committee meetings	London (generally)
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### **Recent Topics**

Property Investing	Corporate Bonds	Nov-14
Private Equity Investing	Inflation Hedging	Jun-14
Global Equity Markets	UK Equity Market Investing	Nov-13
New Member Training		Jun-13
Diversified Growth Investing	Global Emerging Market Equity	Nov-12
Liability Hedging Bond Investing	Introduction to LGPS Benefits	Jun-12