DORSET COUNTY PENSION FUND

Quarterly Report 30 September 2015

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YOUR PORTFOLIO

Fund performance objective

The fund objective is to outperform the benchmark by 0.5% per annum gross of the standard management fees.

Fund asset allocation and benchmark ranges

Fund and benchmark index	Fund allocation (%)
RLPPC Over Five Year Corporate Bond Fund iBoxx Sterling Non-Gilt Over 5 Year Index.	100.0

Portfolio value

	Portfolio total (£m)
30 September 2015	**276.23**
30 June 2015	273.13
Change over quarter	3.10
Net cash inflow (outflow)	0.00

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EXECUTIVE SUMMARY

Performance

- The fund gave a gross return of 1.13% over the quarter, compared with a benchmark return of 1.26%. This brings 2015 performance to 0.48% versus the benchmark of -0.19%.

The economy and bond markets

- Global activity news has been mixed over quarter three. The UK economy grew by 0.7% in the second quarter and recent data indicate this momentum continued into quarter three, albeit at a somewhat slower pace. UK Consumer Price Index inflation, although rising to 0.0%, has remained persistently low and has led commentators to question whether the 2% target could be achieved on a two to three year horizon. The Bank of England kept the base rate at 0.5% with the majority of its Monetary Policy Committee members in agreement on maintaining rates at the current level.
- US GDP growth for quarter two was revised higher from initial estimates to 3.9% annualised, a very strong rebound from the 0.6% recorded for quarter one. The US Federal Reserve signalled that, depending on data, a rise in interest rates was likely before the end of the year. Eurozone growth and inflation remained stable, with GDP growth revised marginally higher to 0.4% and core CPI at 0.9%. The picture in China deteriorated as equity market weakness, a change in currency arrangements and weaker manufacturing data raised concerns about the extent of the economic slowdown.
- Conventional gilts returned 3.12% over the quarter; yields fell across all maturities. Medium dated gilts outperformed short and long dated gilts on a duration adjusted basis. Gilts outperformed US and European equivalent government bonds. Government bond yields in overseas markets fell with peripheral and semi core eurozone bonds outperforming German bonds. Index linked gilts returned 1.93% as the slump in the oil price led to the re-emergence of deflation concerns; breakeven (implied) inflation rates fell across maturities.
- Sterling investment grade credit bonds returned 0.91%, reflecting the fall in gilt yields and a widening in credit spreads from 1.22% to 1.49%, a level last reached in quarter three 2013. All sectors saw some widening in credit spreads with secured and structured bonds, covered bonds and supranational debt the strongest performers. Basic industry and autos were the weakest areas, impacted by the drop in commodity prices and the emission testing scandal at Volkswagen. All sectors underperformed gilts. Returning -4.51%, global high yield bonds underperformed, reflecting heightened risk aversion and a sector bias towards industrial companies.

Investment outlook

- Our central case is that the current global expansion will be sustained into 2016.
- We expect global government bond yields to trend higher as concerns about global deflationary pressures ease and we move closer to rate rises in the US and UK. We expect a very gradual rise in policy rates and not a dramatic sell-off in government bonds over the next twelve months. We believe that long term real interest rates of -0.81%, seen at the end of September, do not reflect long term economic fundamentals.
- While we expect significant challenges in sterling fixed income markets, we believe that the pricing of credit bonds undervalues the asset class, relative to government bonds. We expect that sterling investment grade credit bonds will outperform gilts by approximately 2.0% p.a. over the next three years.

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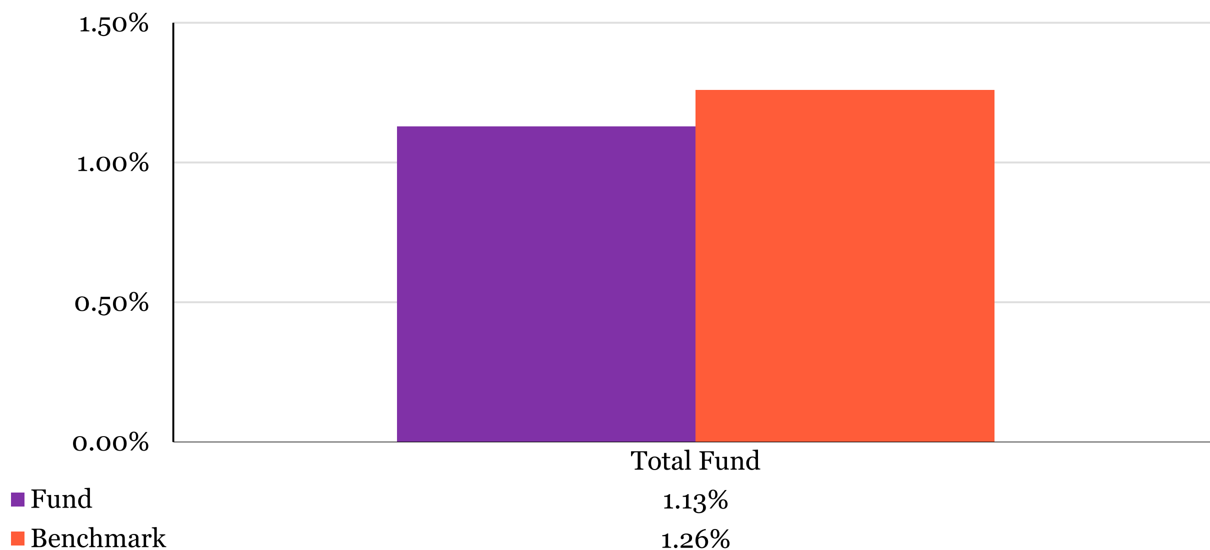
FUND PERFORMANCE

The table below shows the gross performance of your portfolio and the benchmark for the periods ending 30 September 2015:

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Q3 2015	**1.13**	**1.26**	**-0.13**
Year to date	0.48	-0.19	0.67
Rolling 12 months	5.74	5.28	0.46
Three years p.a.	7.51	5.77	1.74
Five years p.a.	9.92	9.43	0.49
Since inception 02.07.07 p.a.	9.16	9.41	-0.25

Quarterly performance



The total fund returns in the above chart include the impact of the cash holding during the quarter.

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RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 3 2015

Asset split

	Fund (%)	Benchmark[1] (%)
Conventional credit bonds[2]	97.3	98.8
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	2.5	0.0
Sterling index linked gilts	0.0	0.0
Foreign conventional sovereign	0.2	1.2
Foreign index linked sovereign	0.0	0.0
Derivatives	0.0	0.0

Fund data

	Fund	Benchmark[1]
Duration	9.7 years	10.0 years
Gross redemption yield[3]	3.96%	3.50%
No. of stocks	301	693
Fund size	£345.5	-

Launch date: 02.07.2007
[1] *Benchmark: iBoxx Sterling Non-Gilt Over 5 Year Index.*
[2] *Conventional credit bond allocation includes exposure to non-sterling credit bonds and CDs, where applicable.*
[3] *The gross redemption yield is calculated on a weighted average basis.*
Figures in relation to the asset spilt table exclude the impact of cash where held.

Performance

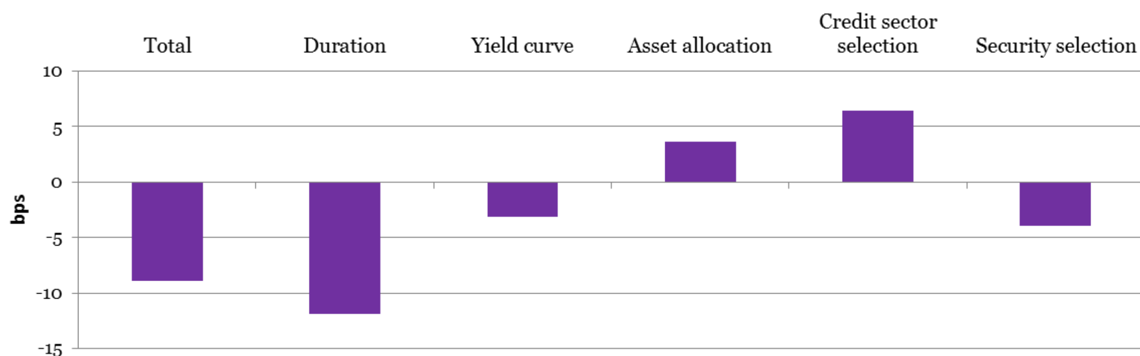
	Fund (%)	Benchmark[1] (%)	Relative (%)
Q3 2015	**1.17**	**1.26**	**-0.09**
Year-to-date	0.61	-0.19	0.80
Rolling 12 months	5.87	5.28	0.59
3 years p.a.	7.50	5.77	1.73
Since inception p.a. (02.07.2012)[2]	9.25	7.42	1.83

[1] *Benchmark: iBoxx Sterling Non-Gilt Over 5 Year Index.*
[2] *The Fund launched 02.07.2007 but its benchmark and objective changed on 02.07.2012.Performance prior to 02.07.2012 has therefore been omitted. If you require performance prior to this change, please contact your client account manager.*

The Fund objective is to outperform the benchmark by 0.80% per annum gross of the standard management fees.

The Fund returns in the above table are gross of standard management fees and include the impact of cash holdings over the period.

Attribution



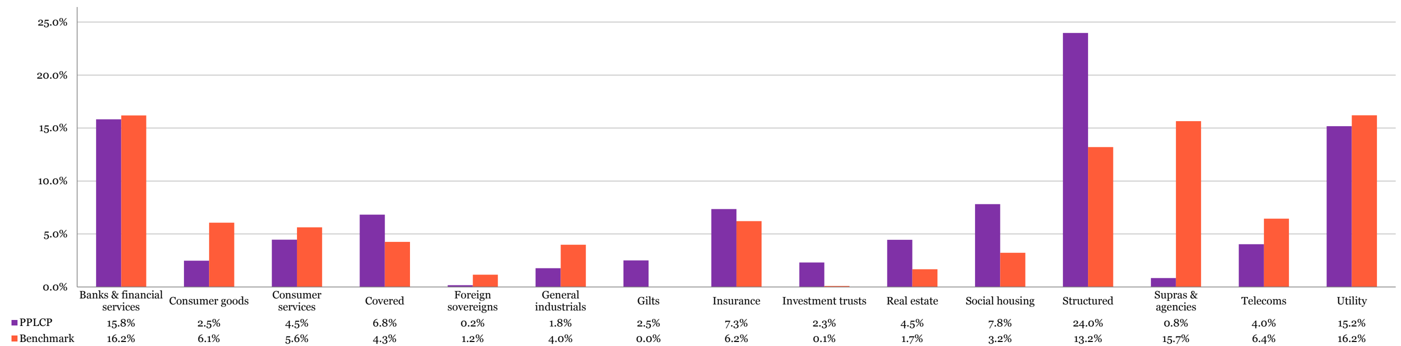
Source: *rlam and UBS Delta. The above performance attribution is an estimate.*

ROYAL LONDON

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 3 2015

Sector breakdown



Source: *rlam. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio.*

What we thought	What we did	What happened	Effect on portfolio
We expected that corporate bonds would outperform supranational debt.	We maintained the underweight position in supranational bonds.	Supranational bonds outperformed the overall sterling credit market as the slowdown in China and problems in emerging economies impacted the corporate sector.	The underweight position in supranational debt had a negative impact on fund performance.
We continued to prefer a combination of covered bank bonds and subordinated bank debt to senior bonds.	The underweight exposure to senior unsecured bank debt was maintained.	Covered bonds outperformed unsecured senior financial debt over the quarter; subordinated bonds performed relatively poorly.	The overweight exposure to subordinated debt was partially offset by the preference for covered bonds over senior financial debt. Despite subordinated financial debts' subdued performance over quarter three, sector returns year-to-date have outpaced those of senior unsecured bank debt.
We thought that high profile consumer orientated bonds were unattractively priced relative to corporate debt. We maintained an underweight exposure to industrial bonds.	The underweight exposure to consumer and industrial sectors was broadly unchanged over the quarter.	Consumer orientated bonds were relatively defensive over the period. Conversely, industrial bonds were impacted by the commodity slowdown, in particular bonds of **Glencore**, and the diesel engine scandal at **Volkswagen**.	The low weighting in industrial bonds, specifically mining and auto companies, was a positive factor in relative performance. The Fund has no exposure to Volkswagen bonds and only a small position in Glencore.
We continued to believe that secured bonds were undervalued relative to unsecured debt.	We maintained a significant overweight position in sectors that benefit from enhanced security e.g. asset backed securities (ABS), social housing and investment trusts.	Credit spreads in secured and ABS bonds widened over the quarter but, reflecting their more defensive characteristics, generally outperformed the overall market.	The Fund's exposure to ABS was beneficial.

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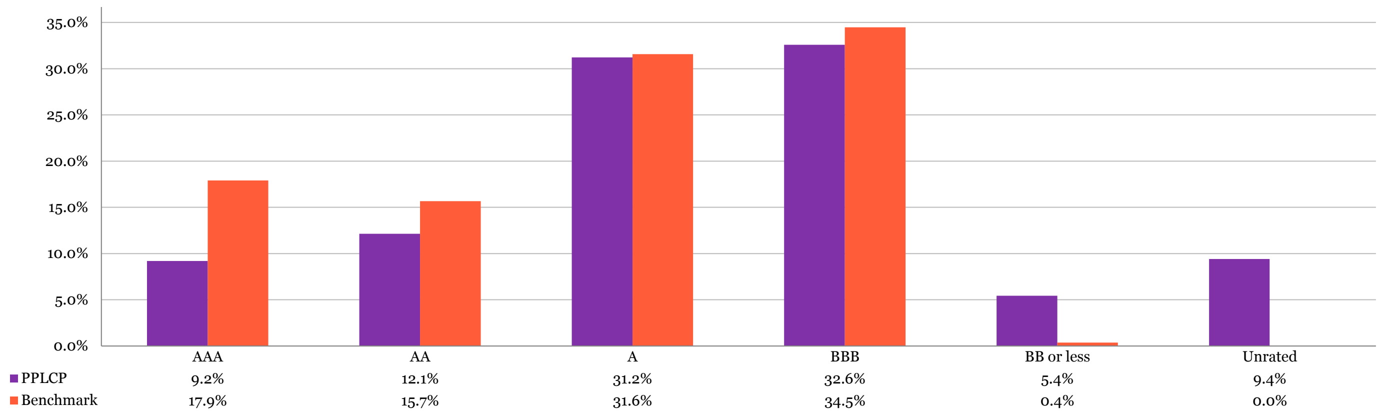
RLPPC OVER 5 YEAR CORPORATE BOND FUND

Quarter 3 2015

Rating breakdown



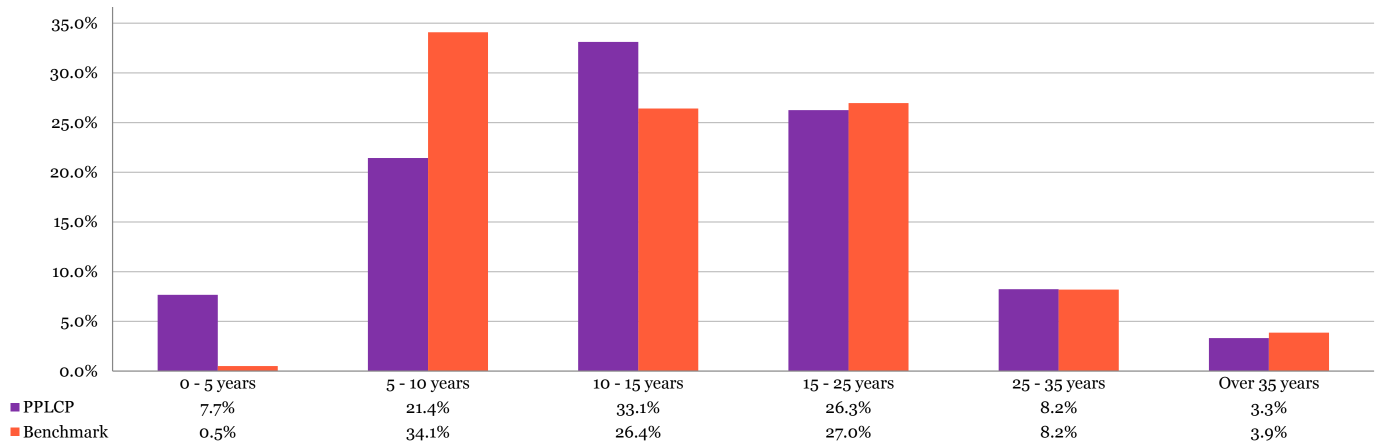
Source: *rlam. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio.*

What we thought	What we did	What happened	Effect on portfolio
We believed that lower rated credit bonds offered better value than AAA/AA rated securities.	We maintained an underweight position in higher rated debt.	BBB rated credit bonds underperformed, reflecting greater risk aversion over the quarter.	The credit rating profile of the portfolio was detrimental.
We thought higher yielding bonds would outperform investment grade credit.	We maintained exposure to bonds rated below investment grade where we believed they were consistent with the overall objective of the Fund. In part this was done through exposure to the Royal London Sterling Extra Yield Bond Fund. Exposure to unrated bonds, which predominantly have investment grade risk characteristics and are in many instances secured, ended the quarter at 9.4%.	Most sub-investment grade bonds weakened in line with the overall investment grade credit market. In particular, **Petrobras** was impacted by governance issues, weakness in the oil price and the downgrade of Brazil's sovereign debt.	Exposure to bonds rated below investment grade detracted from performance; the Royal London Sterling Extra Yield Bond Fund returned -0.32% over the quarter, bringing its year to date return to 2.68%. The Fund had a small exposure to Petrobras. We took the decision to reduce this position in the latter part of the period, ending the quarter with a 0.16% exposure to the issuer.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 3 2015

Maturity profile



	0 - 5 years	5 - 10 years	10 - 15 years	15 - 25 years	25 - 35 years	Over 35 years
PPLCP	7.7%	21.4%	33.1%	26.3%	8.2%	3.3%
Benchmark	0.5%	34.1%	26.4%	27.0%	8.2%	3.9%

Source: *rlam. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio.*

What we thought	What we did	What happened	Effect on portfolio
We expected that UK government bond yields would rise.	The Fund's short duration stance maintained over 2015 was kept within a range of 0.1 to 0.5 years below benchmark.	Although most pronounced in medium-dated bonds, yields fell across the maturity spectrum as market volatility rose and investor risk appetite declined.	The short duration position was a negative factor in relative performance.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 3 2015

Ten largest holdings

	Weighting (%)
Lloyds 6% 2029	1.3
Commonweath Bank of Australia 3% 2026	1.1
Finance For Residential Social Housing 8.369% 2058	1.1
Co-operative Bank 4.75% 2021	1.0
Abbey National Treasury 5.75% 2026	1.0
Annington Finance 0% 2022	1.0
Equity Release 5.7% 2031	0.9
Bank of America 7% 2028	0.9
Equity Release 5.88% 2032	0.9
Great Rolling Stock 6.875% 2035	0.9
Total	**10.1**

Source: *rlam. Figures in the table above exclude derivatives where held.*

ROYAL LONDON

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 3 2015

Fund activity

- Liquidity in sterling credit markets continued to be influenced by regulatory pressures on banks, with less capital being devoted to market making of securities. Primary sterling credit issuance tailed off over the quarter, impacted by the usual summer lull as well as increased risk aversion by investors, reinforcing the adverse liquidity trends. The weakening sentiment reflected a combination of factors, including some on-going concerns about Greece, unease about the pace of economic growth in China and the impact this could have on the global economy, a worsening economic outlook for many emerging market economies and fears that the US Federal Reserve was poised to raise official rates. Nevertheless the fund participated in several new issues:
  - **WoDS Transmission**, an electricity transmission business connecting the 108 turbines of the West of Duddon Sands wind farm located in the East Irish Sea to the National Grid. The business operates under the Offshore Transmission Operator (OFTO) regulatory regime, and is amortising over their life and was issued at a credit spread of 1.45% over the reference gilt, an attractive price relative to existing OFTO deals.
  - **Stagecoach**, primarily a UK regional bus business, but benefitting to various degrees from diversification in UK rail and US bus services, issued a £400 million, 10 year, BBB rated bond. The bonds were issued at 2.22% over the reference gilt, which compared attractively to peers with lower margins, higher leverage and weaker cash generation.
  - **Metropolitan Housing Association** issued the first new deal in the sector following the contentious July Budget announcements of rent reduction, further welfare reform changes and an extension of the right to buy programme. The long dated, £250 million bond was issued at a yield of 1.67% over the reference gilt, an attractive premium reflecting recent uncertainty.
  - **Apple Inc** issued its debut sterling-denominated bonds at elevated coupon levels relative to its very strong AA+ rating.
- Despite low levels of liquidity, activity in the fund was relatively high. We added to several secured / structured bonds, including covered bonds from **Lloyds** and **Commonwealth Bank of Australia**, **Intu**, **Broadgate**, **Exchequer Partnership, Places for People, Madejie Investment Trust,** and **Guinness Northern Counties**. We continue to believe that secured debt represents good value in the sterling credit market.
- Several unsecured bonds were also purchased, including **Times Warner Cable**, **Glencore**, **Credit Suisse** and **Great Rolling Stock**. In addition, weakness in **RWE**, following the introduction of new regulations by the German government earlier in the year, allowed us to increase marginally the Fund's position. The purchase reflected our view that the rise in yield compensated for the impact of lower commodity prices; the bond price continued to decline after the purchase.
- Sales were undertaken across sector to finance the purchase of new issues, and included **Hammerson, Thames Water, Sceptre Funding, Greater Gabbard**, **BAT** and **Deutsche Telecom**. These sales reflected our view on relative valuations. In the latter part of the quarter we reduced exposure to **Petrobras**, reflecting the deteriorating credit profile of the company and the downgrade of Brazilian sovereign debt in the quarter.
- Poor Chinese economic data and weakness in many commodity prices saw credit spreads widen in the industrial sector. **Glencore** was noticeably weak over the quarter, despite announcing a $10 billion debt-reduction plan, including a $2.5 billion equity placing, a 20% cut in copper production and a suspension of dividend payments. Over the quarter and year-to-date, Glencore has been the weakest constituent of the FTSE 100 whilst the bonds have widened significantly, underperforming both the sector and broader sterling credit market. The fund has a modest exposure to Glencore in line with the benchmark, and is underweight the broader commodity and energy sectors.
- As expected, Lloyds Bank called a tier 2 bond issued by its subsidiary, **Scottish Widows**, at the first available opportunity.

Key views in your portfolio

- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration shorter than that of the benchmark, as we expect underlying gilt yields to rise.
- A bias towards asset backed securities, an area that we believe still offers the best risk/return characteristics.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- Targeted exposure to higher yielding bonds through investment in the Royal London Sterling Extra Yield Bond Fund.

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ECONOMIC REVIEW

Key points

- Since June global activity news has been mixed, with some positive news in the advanced economies, offset by negative surprises in emerging markets.
- US GDP growth for quarter two was revised higher from initial estimates, while employment growth remained solid. The US Federal Reserve signalled that a rise in interest rates was likely before the end of the year, although dependent on continued strong labour market data and a reduction in financial market volatility.
- In the eurozone, GDP growth was also revised upwards, with little sign of any China impact to date; bank lending rates have fallen and monetary growth numbers have responded to the improvement in credit conditions. Inflation remains very low and the ECB has continued to undertake asset purchases of €60 billion per month.
- China-related worries increased during the summer, owing to a combination of three local developments: equity market weakness, a change in currency arrangements and weaker manufacturing data. The authorities are seeking to balance competing goals of structural reform and maintaining GDP growth close to 7%. The picture is complicated by the fact that some parts of the economy (industrial production) and some regions are slowing, while other parts of the economy (services) and the more diversified regions appear more resilient.
- The UK economy grew by 0.7% in the second quarter of 2015, while the most recent business surveys (including PMIs) suggest that momentum continued into quarter three, albeit at a somewhat slower pace. The annual rate of inflation has fallen to a record low which, together with a recovery in employment and earnings growth, is supporting real household incomes and consumer spending.
- Trade weighted sterling weakened a little during the quarter, falling against both the dollar and the euro. On a trade weighted basis, sterling now stands around 15% above its level in quarter one 2013. The sharp pickup in the UK's relative economic growth rate explains much of this.

BOND MARKET REVIEW

Investment grade financial & corporate bonds

Key points

- Sterling investment grade credit bonds returned 0.91% over quarter three, underperforming UK government bonds by 1.74%, duration adjusted. The positive absolute return was due to the fall in long dated interest rates whilst the disparity between the two asset classes' returns reflected a widening in credit spreads, the average yield differential between sterling investment grade credit bonds and UK government bonds.
- Credit spreads widened from 1.22% to 1.49%, a level last reached in quarter three 2013. All sectors saw some widening in credit spreads.
- Bank debt performed broadly in line with the wider credit market although both senior and covered bonds outperformed. Insurance was one of the weakest sectors, delivering a return of -0.18% over the quarter.
- Reflecting their more defensive characteristics, asset backed and secured bonds tended to outperform. Conversely, the utility sector underperformed, as several large integrated electricity businesses (RWE and EON) were perceived to be disadvantaged by changes in German regulation of nuclear power.
- Basic industry and autos were the weakest areas over the quarter. The slowdown in China and emerging economies resulted in the bonds of companies associated with commodity trading and production performing poorly (e.g. Glencore, BHP and Anglo American). Likewise, the emission testing scandal at Volkswagen, in the latter part of the period, resulted in weakness in auto-related debt.
- Sterling bond issuance contracted sharply as the quarter progressed and market volatility spiked higher. In contrast to previous quarters this year, issuance was more heavily skewed towards non-financials. With a total of £5bn issued over the period, new bond supply was broadly in line with quarter three 2014, although year to date volumes remained markedly below comparable 2014 levels.
- Returns were broadly correlated with credit ratings. AAA rated bonds outperformed lower rated bonds.
- By maturity, the highest returns were recorded by longer dated bonds, reflecting the effect of falling gilt yields.

Outlook

- Liquidity in credit markets again deteriorated, reflecting the on-going capital constraint on banks (fewer resources available for trading fixed income securities) and heightened investor concerns about global economic growth. We expect liquidity conditions will remain challenging in the medium term.
- We believe that the current credit spread premium, over UK government bonds yields, adequately compensates for default and other risks (e.g. liquidity and rating migration). We expect that investment grade credit bonds will outperform UK government securities by more than 2.0% p.a. over the next three years.

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BOND MARKET REVIEW

Conventional government bonds

Key points

- Conventional UK government bonds returned 3.12% over quarter three as the market rallied on falling oil prices and equity market weakness. On a duration adjusted basis, medium dated gilts outperformed short and long dated gilts. In addition the European Central Bank (ECB) discussed increasing its quantitative easing programme whilst central banks globally continued to cut rates. Over the quarter outperformed both US and European counterparts.
- Government bond yield curves in the UK steepened between ten and 50 year maturities but flattened between two and ten years as the bond market rallied on a flight to quality.
- The Bank of England (BoE) Monetary Policy Committee (MPC) left its policy rate and quantitative easing unchanged at 0.5% and £375bn, respectively. Minutes from the MPC meetings showed a change in voting over the course of the quarter from 9-0 to 8-1 in favour of leaving interest rates at the current historically low level. Members highlighted the decrease of slack in the labour market and likely upward pressure on wages as the main justification for not raising rates.
- UK Consumer Price Index (CPI) inflation remained at 0.0%. Second Quarter gross domestic product (GDP) growth was 0.7%, resulting in average annual GDP growth of 2.4%.
- The Debt Management Office announced the issuance schedule for the upcoming quarter, which will be spread across maturities with two short, three medium and two long dated auctions, plus two long dated syndications.
- The ECB European Central Bank continued its bond buying programme and, implied that it could increase quantitative easing if required.
- Yields across the main overseas markets fell; core European government bonds underperformed peripheral eurozone markets, including those of Italy and Spain.

Outlook

- We expect global government bond yields to trend higher from current levels, as economic data continues to improve and we move closer to rate hikes from both the US Federal Reserve and the BoE. Our base case assumes a very gradual rise in policy rates, so we do not expect a dramatic sell-off in government bond markets over the next 12 months.
- Our central case is for UK government bond yields across maturities to rise over 2016, and for the yield curve to flatten, although we expect some volatility around this trend. The high UK budget deficit means that gilt supply will remain heavy and this should exert an upward force on yields as the latest flight to safety abates.

Index linked bonds

Key points

- Index linked gilts returned 1.93% over the quarter; real yields fell across all maturities, with the exception of the 5 year area, as concerns over China and its impact on global growth escalated.
- A 25% collapse in the oil price led to the re-emergence of deflation concerns, despite average earnings data continuing to rise.
- 10 year index linked gilt yields fell by 0.07% over the quarter. Longer dated bonds, supported by structural demand from UK pension funds, outperformed marginally, with real yields falling by around 0.10% over the quarter, having reached new record lows of below -1.00% during the period.
- The current negative level of real yields of -1.31%, -0.86% and -0.81% for 5, 10 and 30 year bonds, respectively, can be contrasted with levels of around 2% when index linked bonds were first issued in the early 1980s, and 4% levels that prevailed in the early 1990s.
- Index linked gilts outperformed their global counterparts. European bonds underperformed, but the worst performing market was the US which lagged the UK by around 0.25% as long dated US breakeven (implied) inflation rates fell sharply with the drop in the oil price.
- Sterling non-government index linked bonds underperformed index linked gilts by around 0.10% over the quarter as concerns over China led to credit bonds, in general, underperforming sovereign bonds.
- UK Consumer Price Index (CPI) inflation rose to 0.0% but the fall in the oil price led commentators to question whether the 2% target could be achieved on a 2 to 3 year horizon, despite domestic price pressures increasing.

Outlook

- We believe that long term real interest rates of -0.81%, as seen at the end of September, are too low and do not reflect long term economic fundamentals.
- Pension fund demand for longer dated real yield securities remains strong but is becoming more sporadic, and long dated real yields at current levels are very dependent on pension fund demand. Index linked gilt supply is expected to be significantly higher over the next three months and will put pressure on longer dated real yields as inflation data improves.
- We continue to believe global inflation linked bonds offer better value than gilts, with real yields of European and US bonds approximately 1.0% and 2.1% higher, respectively, than those of the UK.
- We believe that long dated breakeven inflation rates of 3.27% are above fair value. However, 10 year breakeven rates of 2.61% now look undervalued on a longer term basis.
- We believe that 10 and 30 year UK government real yields will rise during 2016.

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BOND MARKET REVIEW

Overseas government bonds

Key points

- Global bond yields fell significantly over quarter three, reflecting concerns over global growth as the economic picture in China deteriorated and the price of oil dropped by 25%.
- Ten year US government bond yields fell by 0.31%, whilst equivalent German yields fell 0.17%. Peripheral and semi core eurozone bonds outperformed German bonds over the quarter; Italian and French yields fell by 0.61% and 0.21% respectively.
- Economic data in the US was mixed over the quarter. Quarter two GDP at 3.9% annualized was a very strong rebound from the 0.6% recorded for quarter one. However, international concerns and persistently low headline inflation led to the US Federal Reserve keeping policy unchanged.
- Eurozone growth and inflation remained stable, with GDP and core CPI 0.4% and 0.9% respectively.
- Ten year conventional government bond yields in the US, Germany, Japan and the UK were 2.04%, 0.59%, 0.35% and 1.76%, respectively, at the end of the quarter.
- The decline in the price of oil was reflected in the poor performance of global index linked government bonds. Breakeven (implied) inflation rates in Europe and the US fell by between 0.34% and 0.45%.
- Easing of monetary policy expectations led to marginally steeper yield curves globally; 10 year US bonds outperformed longer dated bonds by around 0.05%.

Outlook

- We expect that global economic growth will be sustained over the near term; the risk of significant double dip recession has reduced.
- We expect US growth to remain reasonably strong and expect a move upwards in the Fed Funds rate in 2015.
- Events in the eurozone will continue to dominate market sentiment. Given the historic political capital invested in the region, and the extremely negative consequences of a breakup, we expect the eurozone to survive. However, the situation remains unpredictable. We do not believe that yields on peripheral eurozone sovereign debt are attractive.
- Given the low level of real yields, particularly in the UK, we expect a rise from current levels, though this will be limited by global growth prospects. In the wake of a very deep recession, we do not see an immediate period of sustained inflation, unless economic growth turns out to be much faster than we expect. In the medium term, however, we do not anticipate a prolonged period of deflation, and breakeven inflation rates at current levels still offer longer term value.
- We believe that developed government bonds markets are expensive, and that yields will rise over the next 18 months.

Global high yield bonds

Key points

- Global high yield bonds (BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained, 100% hedged to sterling) returned -4.78%; monthly returns were consistently negative over this period.
- Global new issuance in the quarter was over USD54 billion, down 44% on the same period last year.
- The index yield ended the quarter 1.42% higher at 7.22%, with the average high yield credit spread widening by 1.53% to 6.01% above government bond yields.
- Emerging markets was the weakest performing region returning -5.91%; UK outperformed, returning -0.76%; Europe returned -1.13% while the US and Canada returned -5.26%.
- BB rated bonds outperformed B rated bonds (-4.30% and -5.42% respectively). Outside of the benchmark index, the Global High Yield CCC & Lower index returned -7.22%. Returns were worse at longer maturities.
- July began weakly, with Chinese stocks completing their biggest three-week decline since 1992, and commodity prices tumbling as oil prices fell the most in five months. This overshadowed concerns about Greece, which dissipated over the course of the month as the government accepted the conditions associated with the latest bailout package.
- In August, the same causes produced the same effects, as uncertainties increased with the Chinese central bank devaluing its currency, and oil prices fell the most in six months.
- September was the fourth consecutive month of negative returns for the high yield market, and the worst in over 30 months. Concerns about both emerging markets' slower pace of growth and developed markets' recovery amid fragile economies continued to cast a shadow over risk assets.

Outlook

- We expect the strength of the US recovery to underpin the growth in the global economy in the medium term, despite more challenging economic conditions within the eurozone.
- We expect market volatility as supportive US Federal Reserve monetary policy is withdrawn. We believe bonds with near term catalysts, which mitigate market risk, are an important attribute underlying investment performance over the medium term.
- We continue to believe that global high yield bonds are attractive on a spread basis and overcompensate for default risk, while their level of income generation is also appealing on a relative basis.
- The current low growth and low rate environment provides a benign default climate, facilitating a virtuous cycle of lowering defaults as a result of refinancings. With average yields now higher than average coupons in global high yield, a moderate level of new issuance is expected for the remainder of 2015.

BofA Merrill Lynch Indices: H0UC for US and Canada, HEEC for Europe, EMHB for Emerging Markets, all 100% hedged to sterling

ROYAL LONDON

INVESTMENT OUTLOOK

Key points

- We anticipate that the global expansion will be sustained into 2016, with loose monetary policy, current low bond yields and a lower oil price acting as key supports.
- We expect UK Consumer Price Index (CPI) inflation to remain below the 2% target for some time, as the effects of the sharp decline in commodity prices continue to feed through.
- Investors remain somewhat pessimistic about the prospects for global growth; we expect global bond yields to move higher.

Global economic growth prospects

- We anticipate that the current global expansion will be sustained into 2016, with loose monetary policy, low bond yields and a low oil price acting as key supports.
- Growth in the US is supported by rising employment and real incomes, part of a generally positive impact from lower oil prices, which should offset the drag from the dollar appreciation. In the eurozone, economic growth has surprised on the upside this year; we anticipate modest growth across the region. In China we expect GDP will grow by less than the official target of 7%.
- We expect average annual US gross domestic product (GDP) growth to continue, with private sector demand underpinned by rising employment, supportive financial conditions and the impact of a lower oil price on households and businesses. These factors should offset the effect of US dollar appreciation and the impact of a lower oil price on shale oil production.
- In the eurozone, we assume that economic activity is supported by lower oil prices, a reduction in fiscal austerity and very low interest rates. While headline inflation remains low, wage data across the eurozone suggests any deflationary impetus is not becoming entrenched. The fall in the oil price has boosted the current account surplus.
- We assume a continuation of trend growth in the UK, with household spending supported by a real income growth and rising employment. The most recent business surveys and other data suggest that momentum in the economy overall has slowed somewhat in the third quarter, although it remains positive. Activity in the housing market has picked up, with mortgage approvals for house purchases rising strongly, while net mortgage lending is growing at its fastest pace since 2008. Wage growth has also risen, reflecting a further narrowing in the margin of slack in the labour market and a recovery in productivity.
- In China, we expect GDP growth someway below the official target of 7%, as strength is the services economy is offset by weakness in industrial production. The authorities will continue to use policy easing measures to support activity. Continued global growth, cheaper energy costs and loose policy are expected to support modest GDP growth in Japan. While headline inflation has been driven lower by the drop in energy prices, trends in core and wage inflation offer some tentative evidence that the deflation hold may have been broken. Nonetheless, we expect the Bank of Japan to continue its quantitative easing programme for some time.

Inflation and growth – how will they impact interest rates?

- We expect UK CPI inflation to remain below the Bank of England's 2% target over the next 12 months, as the effects of the recent sterling appreciation, and falls in commodity prices, feed through with lags. Nevertheless, we believe the prospect of deflation is overstated and there will be strong upward base effects from energy prices. Our base case also assumes a gradual firming in wage growth, as the labour market tightens, which should keep CPI close to 2% over the medium term.
- The period of "emergency" monetary policy has yet to create robust growth conditions, and we expect only a marginal policy tightening in the UK and US in 2016. Global economic headwinds remain, with the imbalance between global savings and investment flows requiring lower equilibrium interest rates in the medium term. We assume a gradual profile of rate increases, to a level much lower than in previous rate cycles. Central banks will likely have an asymmetric view of inflation risk, following the financial crisis, while levels of public and private debt have raised the economic sensitivity to changes in the cost of money.

Our views on the outlook for the main bond asset classes

- At current yield levels, we still believe that markets discount quite a bearish view of global growth prospects and expect yields to move higher from current levels, as much of this concern looks overdone. However our base case only assumes a very gradual rise in base rates during 2016, so we do not expect a dramatic rise in yields over the next twelve months.
- Investment grade and high yield credit offer better relative value than government bonds. We believe that strong company balance sheets and central bank liquidity, forcing investors to look for yield, underpin credit valuations.
- We expect returns from investment grade corporate bonds to exceed government bonds by more than 2.0% p.a. over the next three years.

ROYAL LONDON

SPECIAL TOPIC

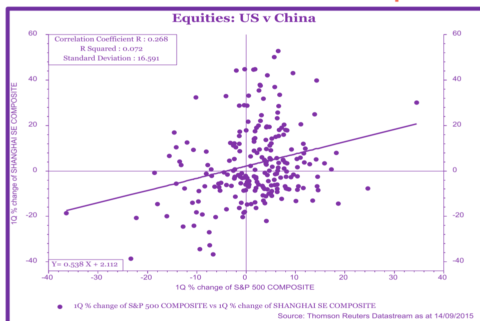
China's economy

- China's economy is now the second largest in the world and the largest single contributor to world growth. As investors, the main problem we confront is that while China is very large, it is still a developing economy, with limited data and a large share of state directed activity.

China data and policy has dominated markets lately

- Economic news from China was the root of market jitters during the summer, although the recent spike in market volatility did not lead to signs of distress within the global financial system, in the manner of 2007/8. With a very thin economic data set and even thinner western understanding of China's political and economic decision process, wild stories about what is "really happening" easily take root. The dominant sentiment in much economic discourse on China is that the authorities "don't know what they're doing".
- This has been fuelled by seemingly haphazard attempts to stabilise the equity market. Falls in share prices have added to a sense of unease, although the link between domestic share prices and China's economy is weak, and the correlation with other major stock markets even weaker (chart 1). China's corporates are not especially dependent on equity financing, while domestic ownership of shares is relatively low when compared with other sources of wealth, such as property.

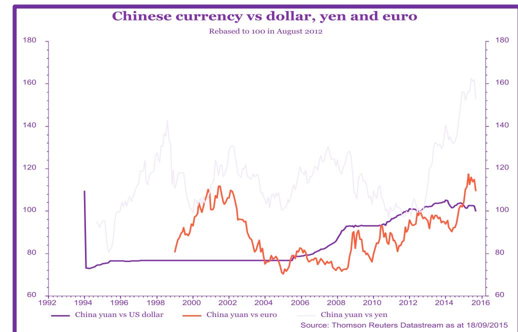
Chart 1: The Correlation Between US and Chinese Equities is Very Low



A surprise devaluation

- A sudden change in China's currency arrangements, followed by weakness in the Caixin manufacturing Purchasing Managers Index, triggered a major dislocation in global equity markets during late August. Three factors lay behind the shift in currency policy: a response to weaker data; a desire to loosen the link with the US dollar; and capital market liberalisation in response to an International Monetary Funds (IMF) request for greater currency flexibility. China wants to be at the top table of economic policy making and this involves a key role for the Chinese Yuan Renminbi within the IMF's Special Drawing Rights (SDR), an elite basket used to set the value of IMF's de facto currency. Keeping the yuan stable against US dollar would just raise the weighting of the US dollar in the SDR.
- So far, the devaluation of the yuan has been very modest, particularly when compared with recent moves seen in the euro and yen (chart 2), so it appears the authorities wish to proceed cautiously. The authorities have eased restrictions on companies seeking to raise finance overseas, which should help to boost capital inflows and provide some offset to capital outflows.

Chart 2: Devaluation Modest To Date



Weaker data but not terrible data

- It is clear that China's manufacturing sector, and the economy more generally, has weakened. However, since much of the "official" economic data such as GDP is now deemed "unreliable", it is difficult to use these surveys to estimate the degree of slowdown, or from what level. It is unlikely that the economy has ground to a sudden halt.
- Manufacturing Purchasing Managers Index's (PMI's) will not pick up the impact of the recent fiscal stimulus on local government financing vehicles, nor trends in the key property development sector. Property sales and prices are now rising, while the PMI for the important services sector has not weakened materially. At any rate, the effects of the recent monetary and Q2 fiscal stimulus will appear only with a lag.
- The one thing we can be sure about is the tension between the authorities' twin goals of financial reform and maintaining stable economic growth. As the UK government discovered in 1992, there is also a parallel tension between trying to control the currency and interest rates at the same time.

More policy ease to come?

- In our view, China does have the policy tools to underwrite growth on a 1-2 year view, albeit at the risk of having to deal with even greater overcapacity issues further down the line. On the monetary side, real interest rates (lending rates less inflation) can fall further, as can Reserve Requirement Ratios, with quantity of money probably more important as a policy than the price of money. There is also room for further fiscal stimulus. Moving from a state driven to a more market driven economy was always going to be a difficult transition, with volatility along the way.
- The key issue for us is whether the slowdown in China is, on balance, beneficial for the global economy. A significant slowdown in China would be a large negative for the global outlook, at least until policy elsewhere could adjust, however a shift to a more sustainable rate would be a benefit not just to China itself but to a large share of global households and firms, especially those in net oil importers, such as the US and more especially the eurozone and Japan. While the Fed and the BoE look set to tighten policy to take account of domestic conditions, the disinflationary pressures from slower growth in China will help keep interest rates lower for longer and provide an important prop for household real income growth.

Source: RLAM. Views expressed are those of RLAM Economist Ian Kernohan.

CORPORATE GOVERNANCE & COMPLIANCE

MiFID (Markets in Financial Instruments Directive)

- Pursuant to the FCA rules and based on information that we hold about you, we have classified you a 'Professional Client'.

Whistleblowing requirements of the Pensions Act

- We confirm that we have not made any reports to the Pensions Regulator during the quarter, as we do not believe there has been a breach of law relevant to the administration of the scheme.

The UK Stewardship Code and Royal London Asset Management

- Our voting records and the details of how RLAM approaches the stewardship of the securities we hold on behalf of our clients are disclosed on our website: www.rlam.co.uk.
- RLAM has a dedicated Governance Team which implements RLAM's Voting Policy across all UK holdings. Our public voting records are fully transparent, searchable and updated on a monthly basis. We also disclose information publicly about our engagement with companies on a quarterly basis.
- RLAM supports the principles of the UK Stewardship Code. Our underlying belief is that management are appointed by the shareholders to manage the business in the best interests of shareholders over time. While engagement is largely from an equity investors perspective, given that in most instances there is a limited amount of leverage that a bond holder can exercise over the issuing company, our own experience is that we are becoming more involved in corporate bond restructuring and in many cases these involve a bond holder vote. We ensure that we approach such decisions in the same way we would on an equity issue in aiming to support management where appropriate but always seeking to enhance value on behalf of our underlying clients.
- All enquiries with respect to our voting and engagement activities should be directed in the first instance to the RLAM Chief Investment Officer.

Responsible Investing

- RLAM is committed to being a responsible investor. This means being a good steward of our client's assets and promoting responsible investment with other stakeholders.
- In 2008, Royal London Asset Management became a signatory to the United Nations Principles for Responsible Investment (PRI), and was an early signatory to the UK Stewardship Code. This set the company on a long-term commitment to making responsible ownership 'business as usual'.
- The aim is to generate sustainable, risk adjusted returns that reflect a wider understanding of what will drive economic performance in the future.
- We seek to understand environmental, social and governance risks and opportunities within the investment process.
- We engage with companies and industry regulators to understand the issues that are most material to their business, and to promote best practice.

Engagement

- Engagement refers to our dialogue with companies, regulators, non-governmental organisations and other agents in the investment chain to support better standards of behaviour, risk management and reform for a more sustainable economy.
- Engagement will normally meet more than one of the following criteria:
- Materiality to investment performance
- Importance to our clients
- Reputational impact
- We track our engagements and report on the outcomes in quarterly public reports and to the PRI.
- We initiate or join collective engagements with other investors where we believe it will be more effective than engaging alone, or to draw attention to a worthy topic.

CORPORATE GOVERNANCE & COMPLIANCE

Sustainable Investing/SRI

- We offer a range of Sustainable Funds that seek to invest in companies well positioned to benefit from products and services that help solve major environmental and social challenges and manage their Environmental, Social and Governance (ESG) risks better than average. This may be through the products and services they offer or by virtue of the fact that while not 'solution' companies in terms of products and services they nevertheless show leadership in their management of ESG impacts.
- We also offer an Ethical Bond Fund and an Ethical Equity Fund aimed at clients that wish to avoid sectors with the highest ethical concerns; namely tobacco, armaments, alcohol, gambling, pornography, nuclear power and animal testing for non-medical purposes. Companies with 10% of revenues or more coming from these activities or those with the worst performance on environmental issues are excluded.

Our relationships with our broker counterparties

- We currently deal through approximately 50 brokers globally; a mixture of global firms and regional specialists which enables us to access different information flows and therefore, enhances the overall investment process.
- We undertake a comprehensive broker rating/review process where all brokers used are scored for the quality and utility of their research, dealing abilities, administrative efficiency, accuracy and sales advice. To get a full picture, we involve fund managers, dealers and any comment from the back-office. We do not have soft commission arrangements with any counterparties.

ROYAL LONDON

RLAM TEAM

Your fund managers

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Head of Fixed Interest

Paola Binns
Senior Credit Fund Manager

Your dedicated contact

James Stoddart
Head of Client Account Management

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In James' absence, please feel free to contact any of the Client Relationship team members listed below or email: ClientRelationships@rlam.co.uk.

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Corporate team changes

Following the departure of Tim Eklund we welcomed Carleigh Young as a Trainee Credit Analyst working within the Fixed Income Team.

Distribution team changes

In September we welcomed John Burke as Head of Institutional, responsible for the growth and direction of RLAM's institutional business. This is a newly created role to help drive our ambitions in this space. John brings a powerful blend of perspectives to RLAM, with over 20 years' experience in financial services, across both asset management and investment consultancy. Previously, he was Head of Business Development at Newton Investment Management, where he worked for over 15 years and was responsible for UK institutional and charity sales and consultant relationships. Prior to this, John was a Senior Investment Consultant for a UK financial services company, advising institutional pension funds on asset strategy and manager selection.

ROYAL LONDON

GLOSSARY

ABS – Asset backed securities – Debt secured against assets of the issuer.

Amortisation – Incremental repayment of a bond over its lifetime.

Attribution – The measurement of a fund's return versus the underlying benchmark return that breaks up the active performance into component parts:

> **Stock selection** – Performance attributed to stock selection.
>
> **Yield curve** – Performance attributed to positioning on the yield curve.
>
> **Duration** – Performance attributed to relative duration of the portfolio versus that of the benchmark.
>
> **Asset allocation** – Performance attributed to asset allocation between fixed interest gilts and credit bonds.

Basel – The Basel Committee on Banking Supervision provides a forum for regular global co-operation on banking supervisory matters.

Benchmark – An index or other market measurement that is used by an investment manager as a standard against which to assess the risk and performance of a portfolio.

Book cost – A measure of the historical cost of a bond or a portfolio of bonds represented as a clean value. It is calculated as the product of the number of bonds held and the average price paid. It remains unchanged regardless of movements in market price. If the price paid is the same as the face value of the bond, book cost will be the same as the nominal value.

Breakevens – The level of inflation required to make the return on index linked bonds equal to return on conventional bonds of similar maturity.

Capital cover – The degree to which debt is covered by the assets of the issuer.

Certificate of deposit (CD) – A certificate of deposit is a negotiable receipt issued by a deposit taking institution in respect of a specified sum of money deposited with that institution at a fixed rate of interest, with an undertaking to repay to the bearer of the certificate at a specified date the sum deposited with interest outstanding. The term of a CD generally ranges from one month to five years – with annual interest payments for those that are issued for longer than a year.

CDO – Collateralized debt obligations – A relatively small subset of the wider ABS market, CDOs are securitisations of a pool of debt receivables (that are not secured on tangible property). Typically, these securities are divided into different tranches: senior tranches, mezzanine tranches and equity tranches. Losses are applied based on the seniority of the tranche, with the most junior tranche absorbing losses first. The bonds are tranched to provide investors with different levels of seniority and credit rating. Variations include collateralised loan obligations (CLOs) and collateralised synthetic obligations (CSOs), where the underlying pools of assets are corporate loans and credit default swaps (that are not secured on tangible property).

Consumer price index – An index number calculated as the weighted average price of consumer goods and services.

Coupon – Interest paid by the bond issuer expressed as a percentage of the face value of a bond; typically paid annually or semi-annually.

Covenant – Legal rules found in bond documentation that place restrictions on the issuer.

Covered bond – Senior bonds issued by banks and collateralised by a high quality pool of residential mortgage assets.

CDS – Credit default swaps – Insurance purchased to protect against the default of a bond. In the event of default, the CDS buyer receives the face value of the bond in return for delivering the bond to the provider of protection.

Credit rating – A rating agency (Moody's, S&P, Fitch) measure of the credit worthiness of a bond issuer – investment grade credit ratings range from AAA to BBB with BB and below referred to as sub-investment grade (sometimes known as 'junk bonds' or 'high yield'). In general, for investment grade credits the rating agency rates only on the probability of default and does not take into account the potential recovery prospects of the bond.

Credit spread – Extra yield offered to compensate the holder of a credit bond versus an underlying risk free bond of similar maturity. Specifically, the holder requires compensation for the expected loss on default, reflecting a combination of probability of default and recovery rate on default. Compensation may also be required for extra market risk and liquidity risk.

Cyclicals – Bonds/stocks that are sensitive to the economic cycle.

Default – Failure of a bond issuer to pay the coupon, or principal when required, on a debt instrument.

DTS – Duration times spread – An expression of the portfolio's sensitivity to changes in yield spreads (the difference between the yields of credit bonds and government bonds) based on proportional spread movements. DTS is an appropriate measure for credit portfolios in particular, and for managers with particular skill in sector and stock selection and a focus on these.

Duration – A measure of the sensitivity of the portfolio to small and uniform changes in bond yields across the maturity spectrum. Duration, also referred to as interest rate risk, is expressed in years as a result of the measure's calculation from the weighted average maturity of all of the portfolio's discounted future cash flows.

ECN – Enhanced capital notes. ECN is a subordinated debt instrument issued by Lloyds Banking Group as part of the 2009 capital restructuring. The bonds were issued in exchange for Lloyd's existing upper tier 2 and tier 1 bonds and are lower tier 2 in the capital structure. Although the regulator also classifies these instruments as LT2, for the purposes of stress testing they are included in the equity capital base of the bank. Coupon payments of ECNs are not deferrable and the bonds are dated. However, should the core tier 1 capital ratio fall below 5%, the ECNs will mandatorily convert into equity.

European Financial Stability Facility (EFSF) – Agreed in May 2010 by EU member states, the temporary program can issue bonds or other debt instruments to raise funds needed to provide financial assistance to eurozone states in economic difficulty. The EFSF is financed by members of the eurozone.

European Stability Mechanism (ESM) – A permanent rescue fund program designed to replace the temporary EFSF which commenced operations in October 2012.

FRN – Floating Rate Notes – a bond with a variable coupon. Typically, coupons of sterling FRNs are referenced against 3 month LIBOR and are reset quarterly.

Funding for Lending Scheme (FLS) – Launched in July 2012, the scheme is designed to lower bank funding rates by allowing banks and building societies to borrow directly from the Bank of England for up to 4 years. Those that increase lending to UK households and businesses will be able to borrow more in the FLS, and do so at lower cost than those that scale back lending.

Futures – A contract between two parties where one agrees to buy and the other to sell an underlying instrument at a future date at a price agreed at the start of the contract.

FX – Foreign exchange.

Gearing – The level of debt to equity.

Interest cover – The degree to which interest expense is covered by the profit of the issuer.

Interbank rate – Lending rate between banks in the wholesale money market; LIBOR stands for London InterBank Offered Rate.

Internal rating – RLAM's assessment of the creditworthiness of a bond; crucially this takes account not only of the probability of default of a company but also the likely recovery rate on default.

Investment restrictions – Restrictions imposed on the portfolio managers by clients as outlined in the investment management agreement (IMA).

Liability management exercise (LME) – Under certain circumstances, companies can offer to buy back or swap their bonds at a discount to par value in order to boost capital reserves. This process has been used most extensively in the financial services sector and, typically, these exercises have been undertaken at premiums to prevailing market prices.

Loan to value (LTV) – Expressed as a %, the value of the loan to the value of the assets backing the loan.

LDI – Liability driven investment – Investing in order to match liability cash flows with asset cash flows. This is often achieved using derivatives products to overlay a bond portfolio in order to control duration.

LTRO – Long Term Repo Operation – European Central Bank debt facility to provide 3 year term funding to European financial institutions.

Market value – Market value reflects the value of a security after issuance as influenced by movements in underlying gilt prices and the market's assessment of credit risk. The value of bonds held in the portfolio reflects this market value. Although borrowers typically pay coupons on an annual or semi-annual basis, different treatment of the accrual of coupon payments results in two market value definitions.

Market value clean – Accrued interest is calculated separately and not reflected in the clean market value.

Market value dirty – The market value includes accrued interest.

Maturity – Final payment date of a bond, requiring the borrower to repay the bond.

MBS – Mortgage backed securities – An asset backed security (ABS) where cash flows are backed by the principal and interest payments of mortgage loans. RMBS relates to residential MBS. CMBS refers to commercial MBS.

Monoline insurance company – The original business model of the monoline insurers was to provide credit-wrapping (credit insurance) of lower rated bonds by guaranteeing the payment of coupon and principal of the underlying bonds in return for premium payments. This sector had been characterised by decades of unbroken profitability and the consistent maintenance of AAA credit ratings, however, over the past ten years, the focus of the sector shifted from the US municipal market to the credit-wrapping of structured products, such as sub-prime RMBS and CDOs. As losses in these instruments have increased in recent years, concerns have arisen regarding the adequacy of the insurers' claims paying reserves. This has resulted in material rating downgrades within the sector. Following these downgrades, a large majority of credit wrapped bonds are now rated according to the underlying credit quality of the issue rather than the monoline's rating. The main monoline insurance companies are AMBAC, MBIA, FSA and FGIC.

Nominal value – Also known as the face value. It refers to the price of a security when issued. For fixed income assets, nominal value is the product of the number of bonds issued and face value per bond (usually denoted by 1,000). Within the portfolio valuation, nominal value represents a client's holding in a bond expressed at face value**.**

Operation Twist – The name given to the Federal Reserve's monetary policy designed to lower long term interest rates by selling short-term Treasury bonds in its portfolio and buying longer-term Treasury bonds.

Outright Monetary Transactions (OMT) – An unlimited bond-buying scheme aimed at cutting the borrowing cost of debt-burdened eurozone members by buying their short-dated bonds, but only after countries have requested a bailout from the European Central Bank. The scheme was announced in September 2012.

PFI – Private finance initiative – Projects that involve the provision of assets for the public sector by private companies. For instance, the Octagon PFI involves the design, financing, construction and operation of Norfolk & Norwich Hospital by a private company for the Norfolk & Norwich NHS Trust.

Quantitative easing – In March 2009, the Bank of England (BoE) announced its intention to purchase UK government bonds (primarily medium dated UK government bonds) by creating new money (effectively printing money, but electronically). The process was subsequently paused by the Band of England during the first quarter of 2010 and later restarted in the fourth quarter of 2011. This process of purchasing assets through 'printing' money is called quantitative easing (QE).

Redemption yield – The annual interest rate on a bond including any capital gain or loss if it were held to redemption and assuming that all coupon and principal payments are made. If the coupon rate exceeds the redemption yield, then the bond will experience capital loss as it approaches maturity and vice versa.

Sale & leaseback – A process by which a company sells an asset then leases it back.

Securities Market Program (SMP) – A monetary policy tool aimed at providing market liquidity by allowing the European Central Bank to purchase distressed government bonds of peripheral European countries.

Seniority/subordination – Represents a bond holder's relative claim on the assets of an issuer before or after default.

Structured bonds – Bonds issued by a legally separate structure and secured on assets. The structure is often tranched, with different credit ratings for different levels of seniority. The process of issuing structured bonds is often referred to as securitisation.

Sub-investment grade – A credit rating that is below BBB-, also referred to as high yield or junk.

Sub-prime – Riskier mortgage lending to non-prime borrowers.

Supranationals – International non-government agencies/institutions such as the European Investment Bank and the World Bank.

Swaps – A derivative product representing an agreement to exchange one series of cash flows for another.

> **Interest rate swaps** – Exchange fixed cash flows for floating cash flows or vice versa.
>
> **Inflation swaps** – Exchange inflation index linked cash flows for conventional cash flows or vice versa.

Swaption – This derivative gives the holder the option (a right but not an obligation) to enter into an underlying swap.

Tracking error – Defined as the standard deviation of the fund's excess return over the benchmark index return, and generally quoted as an annualised figure based on monthly observations. This measure quantifies how closely the portfolio's return pattern follows that of a benchmark index. It is an important concept in risk measurement, and is used as both an ex post (historic) and ex ante (expected) measure. RLAM employs systems that allow us to estimate the ex ante tracking error of a portfolio.

Underwriting – The process by which an underwriter guarantees the new issue of securities (equity or bond).

Unrated bonds – Bonds that are not rated by any of the rating agencies; traditionally, unrated bonds benefit from security over the assets of the issuer. Unrated bonds are assigned an internal rating by RLAM.

Yield – Interest rate earned on a bond, expressed as an annual percentage.

Yield curve – The relation between the interest rate and the time to maturity of a bond.

Issued by Royal London Asset Management 09/2015. Information correct at that date unless otherwise stated.

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Portfolio Valuation

As at 30 September 2015

Dorset County Pension Fund

	Holding	Identifier	Asset Description	Market Price (Bid £)	Book Cost Capital (£)	Market Cap. Value (£)	Accrued Inc. Value (£)	Market Value (£)	Days Accrued	Market Value %
Funds Held										
	137,848,856	GB00B1ZB3X88	RLPPC Over 5 Year Corp Bond Pen Fd	2.00385	172,696,679.91	276,228,430.09	0.00	276,228,430.09	0	100.0
				Funds Held total	**172,696,679.91**	**276,228,430.09**	**0.00**	**276,228,430.09**		**100.0**
				Grand total	**172,696,679.91**	**276,228,430.09**	**0.00**	**276,228,430.09**		**100.0**

Trading Statement

For period 01 July 2015 to 30 September 2015

Dorset County Pension Fund

	Trade Date	Transaction Type	Nominal	Security	Price (£)	Book Cost (£)
Acquisitions						
Funds Held						
	06 Jul 2015	Acquisition Rebate	103,426.57	RLPPC Over 5 Year Corp Bond Pen Fd	2.03	210,386.20
					Funds Held total	**210,386.20**
					Acquisitions total	**210,386.20**