

Dorset County Pension Fund

Insight mandate investment update at 30 September 2016

Our understanding of the Fund's objectives and strategy

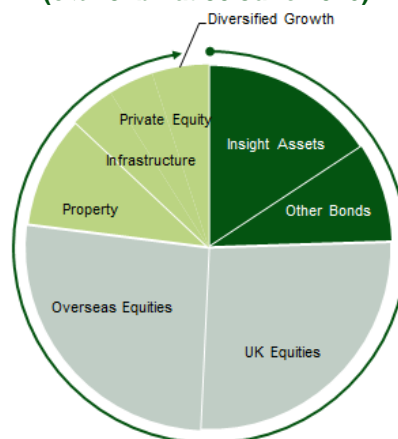
Funding objectives and policy

- To set contribution levels required to build up assets sufficient to meet all future benefit commitments at lowest possible cost
- Investment strategy designed to ensure contributions are as stable as possible

Investment strategy

- Control but not eliminate risk
- Current priority is to mitigate 'unrewarded risks'
 - increase inflation protection
 - consider impact of other liability risks

Strategic asset allocation (c.£2.37bn at 30 June 2016)



Source: Dorset County Pension Fund.

Performance to 30 September 2016

	3 months		12 months		Since inception	
	%	£	%	£	% p.a.	£ cum.
Portfolio	36.48	69,417,790	27.93	56,940,727	78.91	116,356,653
Benchmark	31.23	63,162,017	24.92	52,858,226	75.69	113,935,521
Relative	5.26	6,255,773	3.01	4,082,501	3.22	2,421,132

Impact of leverage: The % returns shown here are expressed as a proportion of the benchmark value, which is materially smaller than the value of the inflation exposure being hedged. Consequently, the % returns are all larger (in absolute terms) than they would be if expressed as a proportion of the liabilities hedged. Inception date for performance purposes: 31 October 2012

If we adjust for the leverage in the portfolio: the benchmark return over the quarter was 5.7% as a proportion of the value of the inflation exposure hedged and the portfolio return was 6.2% on that basis.

Portfolio valuation and hedge characteristics as at 30 September 2016

	Value	Interest rate sensitivity (PV01 ¹)		Inflation sensitivity (IE01 ²)	
	£m	£k	% of benchmark	£k	% of benchmark
Conventional gilts	385.7	-702	97.2	0	0.0
Index-linked gilts	335.5	-928	128.5	909	37.0
Futures	0.8	76	-10.5	0	0.0
Interest rate swaps	-139.2	928	-128.6	0	0.0
RPI swaps	13.5	-102	14.1	1,544	62.8
Repurchase agreements	-246.5	2	-0.3	0	0.0
Network Rail bonds	4.1	-11	1.6	11	0.5
Insight Libor Plus Fund	12.0	0	0.0	0	0.0
Liquidity	6.9	0	0.0	0	0.0
Total assets	372.8	-737	102.1	2,465	100.2
Liability benchmark	265.8	-722	100.0	2,459	100.0

¹ PV01: change in present value of a series of future cash flows resulting from a 0.01% shift in the relevant discount curve.

² IE01: change in present value of a series of future cash flows resulting from a 0.01% shift in the relevant inflation expectation curve.

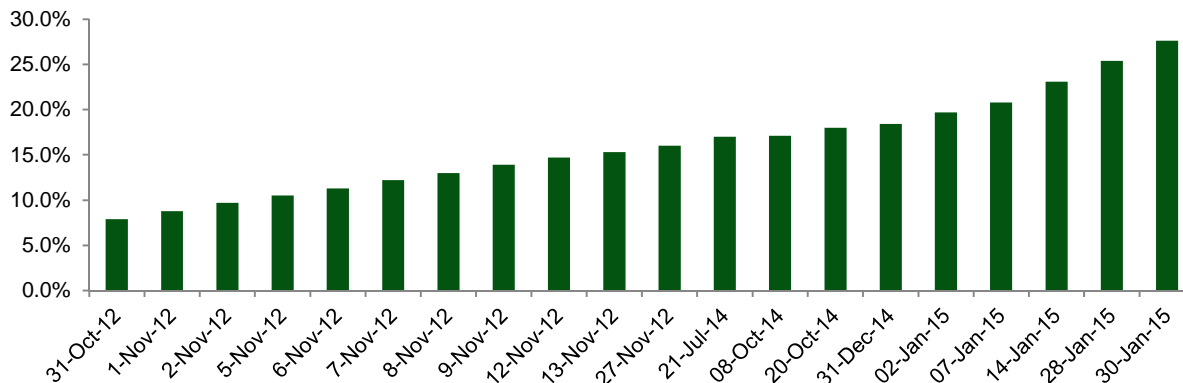
DORSET COUNTY PENSION FUND

Hedge coverage measures

- Liability benchmark inflation sensitivity as % of mandate cash flows: 22%
- Present value of inflation exposure hedged as % of mandate cash flows: 28%
- Present value of inflation exposure hedged as % of Pension Fund assets*: 58.0%

*using June 2016 asset value

Inflation hedge accumulation progress - shown over time as proportion hedged of mandate cash flows.



- The hedge was accumulated initially using market based triggers
- A time-based underpin was put in place on 1 July 2014. On a quarterly basis, depending on how many triggers have been hit previously, the hedge was increased incrementally to target 36% over 5 years. We have accumulated under the time-based underpin twice, on 21 July 2014 and 20 October 2014.
- The triggers are reviewed by Insight and Dorset periodically to ensure they remain appropriate to the Fund's overall objectives. The latest version was put in place in March 2015 with the remaining triggers being lowered. Triggers were suspended in March 2016 pending further discussion of the evolution of the mandate.
- Discussion of the evolution of the mandate took place during the third quarter of 2016 and a new set of investment guidelines was put in place in October. The hedge was therefore restructured post the quarter end to reflect the change to the projected liability cash flows based on the March 2013 actuarial valuation. Triggers are no longer being monitored.

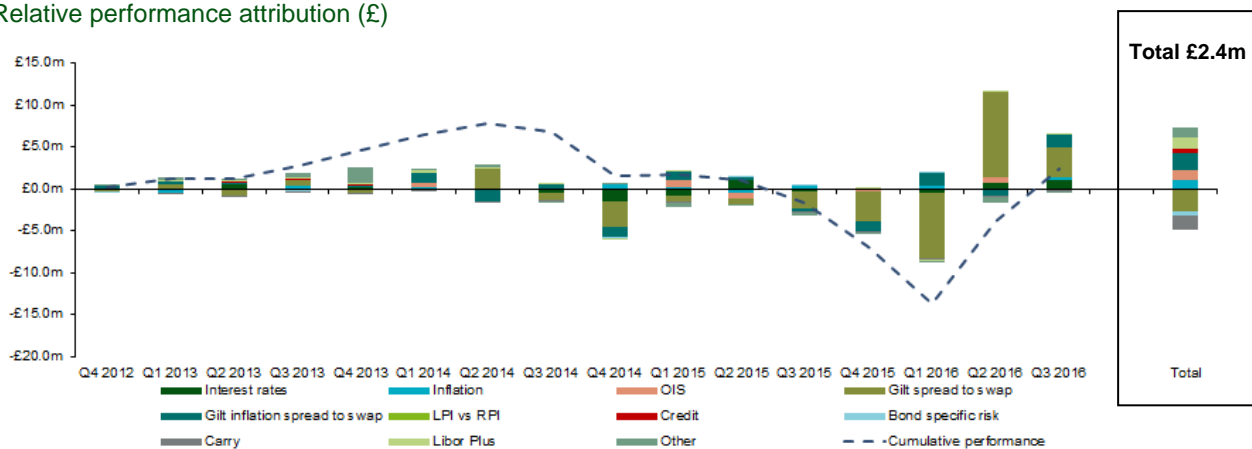
Collateral position

- A further £30m of collateral was added to the portfolio in August.
- Leverage ratio stood at 3.7x at 30 September 2016. This is based on the present value of liabilities covered by inflation hedge of £1.39bn and a portfolio value of £373m.
- Collateral stress tests: a 0.2% fall in inflation expectations (swap RPI rates) would reduce the value of the portfolio by c.£49m and a 0.6% fall in inflation expectations would reduce the value of the portfolio by c.£148m.

Performance commentary

- Absolute performance in the third quarter of was driven by large falls in index-linked gilt yields (20 year rate fell 0.44% to -1.80%) and rises in the cost of inflation protection in the swaps market (20 year rate rose 0.20% to 3.38%).
- Within the portfolio Insight has the ability to change the composition of hedging assets with a view to cheapening the cost of hedging over the long term. The chart below shows the performance attribution of the portfolio relative to its benchmark since inception.
- The allocation between swaps and gilts in the portfolio has been the largest single factor in the driver of relative performance over the reported period. From July 2015 through to February 2016, gilts generally cheapened relative to swaps. However, since March 2016 this movement has reversed and consequently the portfolio has outperformed its liability benchmark in the third quarter of 2016. We remain overweight to gilts (vs swaps) as we believe that the extra yield available from gilts creates a significant economic opportunity for the Fund to benefit from over the long term.

Relative performance attribution (£)



	3 month	12 month	Since Inception
Interest Rates	1,060,173	1,201,731	-76,942
OIS	-53,445	371,257	1,173,230
Gilt Spread to Swap	3,581,465	2,506,309	-2,547,353
Credit	0	0	420,331
Bond Specific Risk	-109,783	-207,995	-525,526
Inflation	370,757	651,601	1,004,992
Gilt Inflation Spread To Swap	1,383,739	1,088,837	2,090,042
Carry	-217,517	-756,849	-1,814,865
Libor Plus Fund	271,146	283,058	1,416,688
Other	-30,763	-1,055,450	1,280,534
Relative Performance	6,255,773	4,082,501	2,421,132