Dorset County Pension Fund

Insight mandate investment update at 30 December 2016

Our understanding of the Fund's objectives and strategy

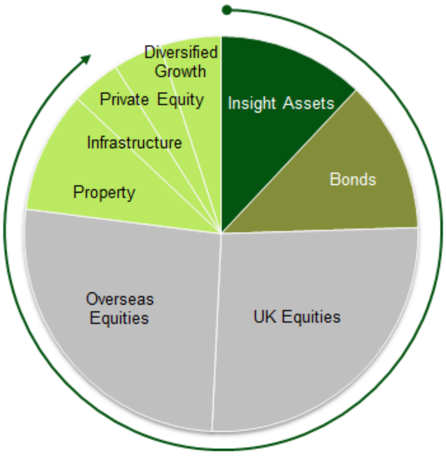
Funding objectives and policy

- 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.£2.66bn at 30 December 2016)



Source: Dorset County Pension Fund.

Performance to 30 December 2016

	3 months		12 months		Since inception	
	%	£	%	£	% p.a.	£ cum.
Portfolio	10.30	27,565,598	48.57	95,135,056	97.33	143,922,251
Benchmark	10.19	27,102,015	41.25	85,409,622	93.58	141,037,536
Relative	**0.11**	**463,583**	**7.32**	**9,725,434**	**3.76**	**2,884,715**

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 2.05% as a proportion of the value of the inflation exposure hedged and the portfolio return was 2.09% on that basis.

Hedge coverage measures

- Liability benchmark inflation sensitivity as % of mandate cash flows: 23%
- Present value of inflation exposure hedged as % of mandate cash flows: 23%
- Present value of inflation exposure hedged as % of total Pension Fund assets: 42.0%

Collateral position

- Leverage ratio stood at 2.8x at 30 December 2016. This is based on the present value of liabilities covered by inflation hedge of £1,122.6m and a portfolio value of £399.9m. The fall in leverage was driven the implementation of the revised liability benchmark and a move higher of inflation expectations.
- Collateral stress tests: a 0.2% fall in inflation expectations (swap RPI rates) would reduce the value of the portfolio by c.£45m and a 0.6% fall in inflation expectations would reduce the value of the portfolio by c.£129m.

Portfolio valuation and hedge characteristics as at 30 December 2016

	Value	Interest rate sensitivity (PV01[1])		Inflation sensitivity (IE01[2])	
	£m	£k	% of benchmark	£k	% of benchmark
Conventional gilts	301.4	-513	62.7	0	0.0
Index-linked gilts	302.7	-811	99.2	796	33.8
Futures	-1.9	71	-8.7	0	0.0
Interest rate swaps	-104.5	592	-72.4	0	0.0
RPI swaps	41.2	-162	19.8	1,533	65.1
Repurchase agreements	-222.5	7	-0.8	0	0.0
Network Rail bonds	3.9	-11	1.3	11	0.4
Insight Libor Plus Fund	12.1	0	0.0	0	0.0
Liquidity	67.5	0	0.0	0	0.0
Total assets	**399.9**	**-827**	**101.1**	**2,339**	**99.3**
Liability benchmark	**290.9***	**-818**	**100.0**	**2,357**	**100.0**

*The value of the inflation exposure hedged is c.£1,122.6m

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

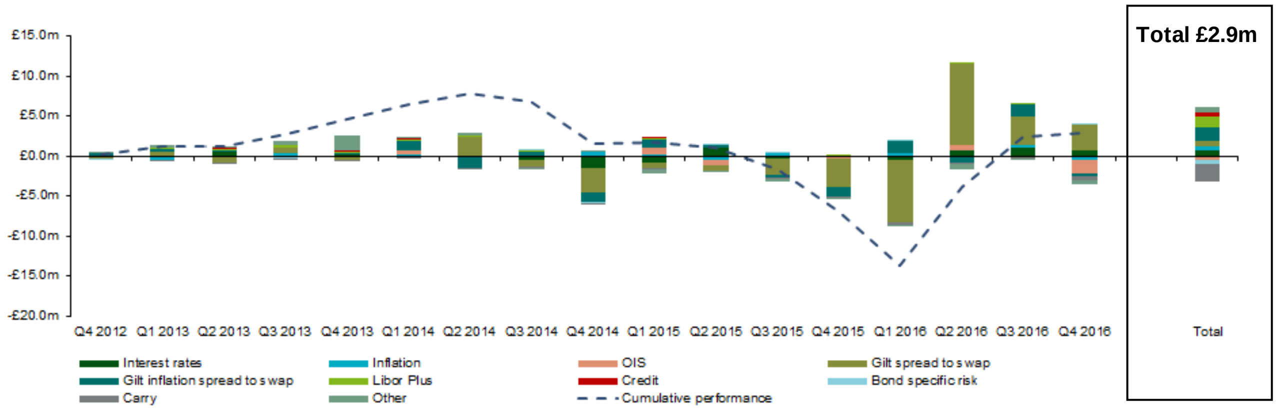
2 IE01: change in present value of a series of future cash flows resulting from a 0.01% shift in the relevant inflation expectation curve.

Performance commentary

- Absolute performance in the fourth quarter of 2016 was driven by a further rise in the cost of inflation protection in the swaps market (20 year rate rose 0.25% to 3.63%), though about half of the impact of this was offset by a rise in gilt rates (20 year bond yield rose 0.4% to 1.93%).
- Yields on longer-dated conventional gilts contracted over the quarter relative to swaps (by 2-3bp), which was a positive driver of relative performance over the period. 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 (monetary)

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 and table below shows the performance attribution of the portfolio relative to its benchmark since inception.



Relative performance attribution factor	3 month £m	12 month £m	Since inception £m
Interest Rates	0.8	2.1	0.7
OIS	-1.7	-1.1	-0.5
Gilt Spread to Swap	3.1	9.3	0.6
Credit	0.0	0.0	0.4
Bond Specific Risk	0.1	0.0	-0.5
Inflation	-0.4	0.2	0.6
Gilt Inflation Spread To Swap	-0.4	1.8	1.7
Carry	-0.5	-1.0	-2.3
Libor Plus Fund	0.1	0.3	1.5
Other	-0.6	-1.6	0.7
Relative performance	0.5	9.7	2.9

Recap of mandate evolution

- The hedge was initially accumulated using market based triggers and also through time-based accumulation between July and October 2014.
- Triggers were suspended in March 2016 pending further discussion of the evolution of the mandate. Subsquently a new set of investment guidelines was put in place in October 2016 and the hedge was restructured to reflect a move to a pro-rate slice of the inflation exposure of the projected liability cash flows based on the March 2013 actuarial valuation. Triggers are no longer being monitored.