DORSET COUNTY PENSION FUND

Quarterly Report 31 December 2016

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YOUR PORTFOLIO

Fund performance objective

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

Fund asset allocation and benchmark ranges

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

Portfolio value

	Portfolio total (£m)
31 December 2016	**304.26**
30 September 2016	312.73
Change over quarter	(8.47)
Net cash inflow (outflow)	0.36

ROYAL LONDON

EXECUTIVE SUMMARY

Performance

- The fund gave a gross return of -2.82% over the quarter, compared with a benchmark return of -3.68%. This brings 2016 returns to 13.18% against a benchmark return of 13.49%
- The election of Donald Trump and the increase in interest rates in the US were prominent themes over the quarter. The ECB announced an extension of its monetary support programme, and the UK economy remained resilient against a backdrop of uncertainty regarding negotiations to leave the EU. The oil price increased significantly following agreements by key suppliers to limit production.
- Credit sector and stock selection were primarily responsible for the relative performance of the Fund. In particular, the Fund benefitted from an overweight allocation to financials and stock selection within secured and structured sectors. Asset allocation and a short duration stance also supported performance

The economy and bond markets

- The election of Donald Trump was the dominant event of the quarter, boosting equity markets, inflation expectations and the US dollar. While the US Federal Reserve (Fed) delivered its much anticipated rate increase in December, on the other side of the Atlantic, the European Central Bank (ECB) extended its quantitative easing programme beyond its original March 2017 deadline. The oil price surged following co-ordinated agreements by the Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC suppliers to cut production and support pricing.
- The UK economy continued to shrug off Brexit in the fourth quarter. During 2016 as a whole, its resilience was largely down to consumer spending. The housing market also remained robust, with a pick-up in mortgage approvals and house price inflation. Nevertheless, protracted political uncertainty continued to dampen 2017 growth forecasts, and to put downward pressure on sterling, with consequent expectations of higher inflation over the coming year.
- Conventional UK government bonds returned -3.43%. Yields rose steeply in response to expectations of higher inflation and following continued resilient UK economic data, while additional gilt issuance announced in the Autumn Statement weighed on the conventional gilt market. Gilts outperformed US bonds but underperformed European government bonds, as the ECB extended its quantitative easing programme. With breakeven (implied) inflation rates rising over the quarter, index linked assets outperformed conventional gilts.
- Sterling investment grade credit returned -2.58%, yet outperformed UK government bonds in absolute terms, despite posting one of its lowest quarterly returns for several years. As bond yields rose, average sterling investment grade credit spreads widened by 5bps to 123bps, but remain close to the lows that followed the BoE's August rate cut.

Investment outlook

- We expect greater momentum in the global economy during 2017, with US growth picking up and growth in China and the eurozone remaining close to 2016 rates. We expect UK GDP growth to slow in 2017 as the economy navigates the uncertainty of Brexit negotiations. We expect UK CPI inflation to rise above target during the year.
- We expect the central banks of the UK, Japan and Europe to retain their biases towards policy easing, while in the US we anticipate three further rate rises in 2017. We expect global government bond yields to rise gradually over the next 12 months, as the inflation outlook and global growth picks up.
- Our central case is for UK government bond yields across maturities to rise over 2017, and for the yield curve to steepen marginally, although we expect some volatility. For index linked bonds, we think long term real interest rates in the UK are too low, and do not reflect long-term fundamentals.
- We expect that investment grade credit will outperform UK government securities over the next three years. We consider that the current credit spread premium, over UK government bonds yields, is adequate compensation for default and other risks (e.g. liquidity and rating migration).
- Portfolio diversification continues to be important during bouts of volatility, and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.

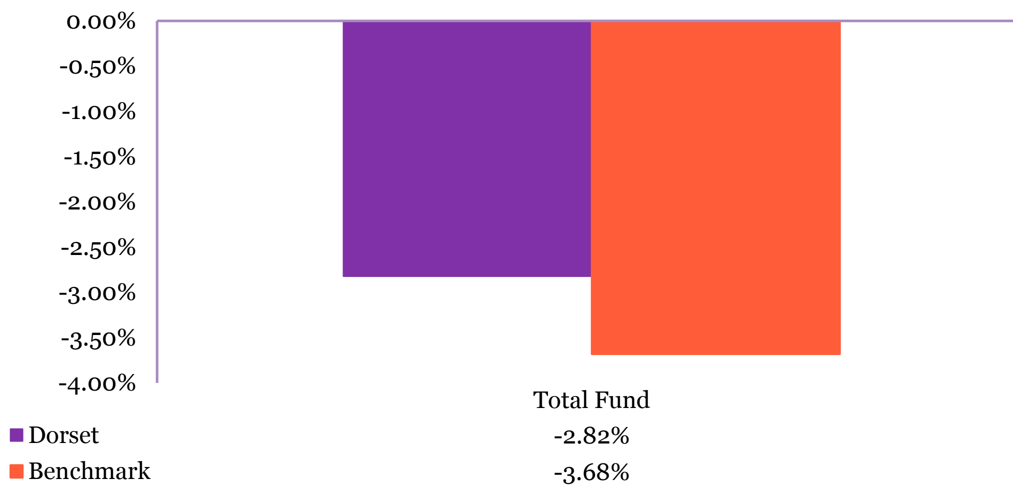
FUND PERFORMANCE

The table below shows the gross performance of your portfolio and the benchmark for the periods ending 31 December 2016:

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Q4 2016	**-2.82**	**-3.68**	**0.86**
Rolling 12 months	13.18	13.49	-0.31
Three years p.a.	9.86	9.51	0.35
Five years p.a.	9.42	7.93	1.49
Since inception 02.07.07 p.a.	9.34	9.61	-0.27

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 4 2016

Asset split

	Fund (%)	Benchmark[1] (%)
Conventional credit bonds[2]	99.6	98.9
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	0.2	0.0
Sterling index linked gilts	0.0	0.0
Foreign conventional sovereign	0.2	1.1
Foreign index linked sovereign	0.0	0.0
Derivatives	0.0	0.0

Fund data

	Fund	Benchmark[1]
Duration	9.9 years	10.4 years
Gross redemption yield[3]	3.30%	2.64%
No. of stocks	285	677
Fund size	£380.2m	-

Launch date: 02.07.2007

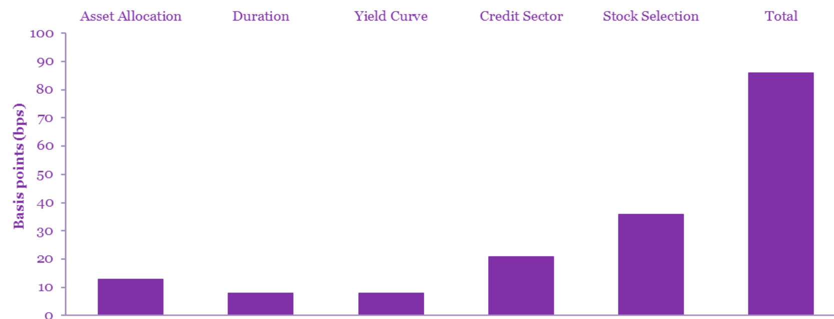
[1] Benchmark: iBoxx Sterling Non-Gilt Over 5 Year Index.

[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 attribution for quarter 4 2016

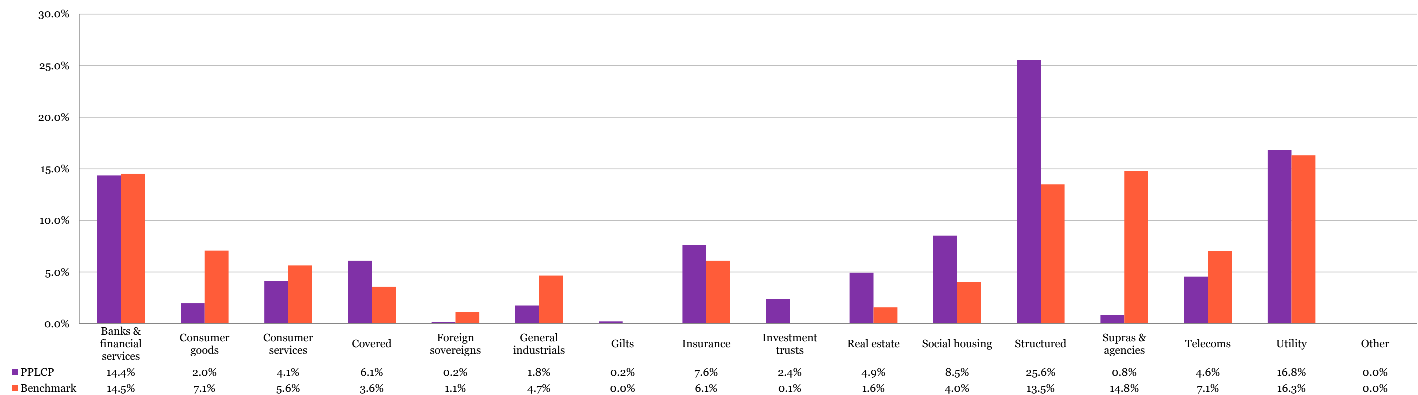


***Source:** RLAM and UBS Delta. The above performance attribution is an estimate. Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.*

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 4 2016

Sector breakdown



	Banks & financial services	Consumer goods	Consumer services	Covered	Foreign sovereigns	General industrials	Gilts	Insurance	Investment trusts	Real estate	Social housing	Structured	Supras & agencies	Telecoms	Utility	Other
PPLCP	14.4%	2.0%	4.1%	6.1%	0.2%	1.8%	0.2%	7.6%	2.4%	4.9%	8.5%	25.6%	0.8%	4.6%	16.8%	0.0%
Benchmark	14.5%	7.1%	5.6%	3.6%	1.1%	4.7%	0.0%	6.1%	0.1%	1.6%	4.0%	13.5%	14.8%	7.1%	16.3%	0.0%

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 overweight position in corporate bonds versus supranational debt.	Supranational debt marginally outperformed the broader credit market over the quarter, but underperformed over the year as a whole.	The Fund's underweight positioning in supranationals had a small negative impact upon relative performance over the quarter.
We continued to see value in financials (banks and insurers), and to favour a combination of covered bonds and subordinated bank debt to senior bonds.	Within financials, the bias towards subordinated versus senior debt was slightly increased over the quarter	The financials sector as a whole outperformed over the quarter, led by subordinated insurance. Senior bank bonds outperformed subordinated bank debt, especially in peripheral Europe where the Italian referendum outcome reignited concerns of another eurozone banking crisis. Covered debt underperformed both senior and subordinated debt. Over the year financials lagged the broader market.	The overweight allocation to, and positioning within, financials was positive for performance, although the preference for subordinated bank debt and covered bonds was less beneficial.
We thought that high-profile, consumer-orientated bonds and industrials were unattractively priced, relative to other sectors.	We maintained the underweight allocation to industrial and consumer sectors.	While consumer sector bonds lagged the market overall, the autos sector was the strongest performer. Conversely, longer dated sectors (healthcare, transport and telecoms) underperformed. Despite some recovery in the oil price, industrials underperformed the market. Over the year, autos were the weakest sector, dogged by ongoing emissions scandals.	The low weighting in industrial and consumer sectors was a positive factor in relative performance, partially offset by the lack of exposure to autos.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 4 2016

Sector breakdown continued

What we thought	What we did	What happened	Effect on portfolio
We continued to believe that secured bonds were undervalued relative to unsecured debt.	We kept the Fund's significant overweight positions in sectors that benefit from enhanced security, e.g. asset-backed securities (ABS), social housing and investment trusts.	Structured and secured sectors performed broadly in line with the market over the quarter, having outperformed over the year as a whole.	Although the overweight positions in structured and secured debt had a neutral impact on performance, stock selection within these bonds was beneficial.

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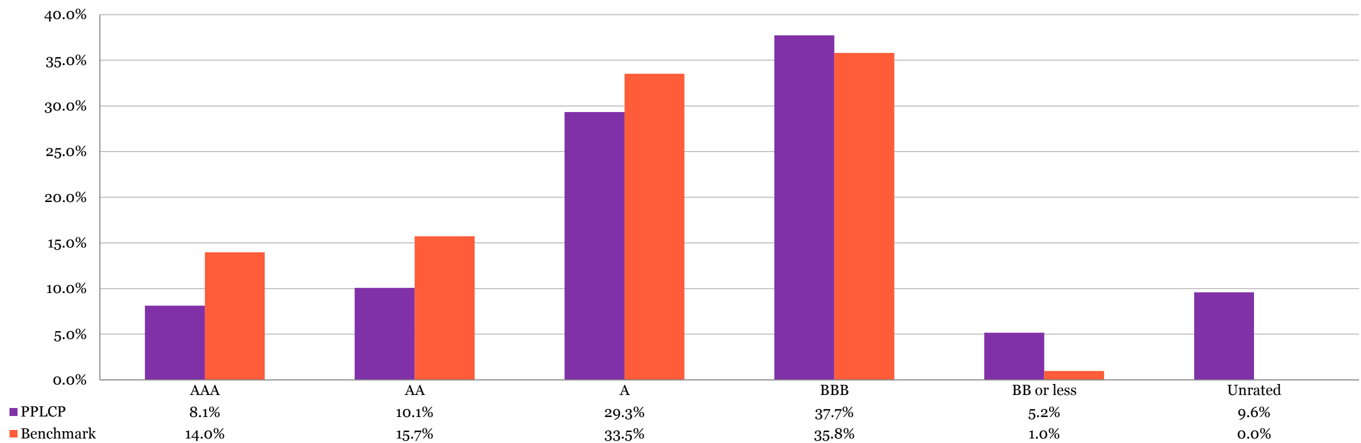
RLPPC OVER 5 YEAR CORPORATE BOND FUND

Quarter 4 2016

Rating breakdown



	AAA	AA	A	BBB	BB or less	Unrated
PPLCP	8.1%	10.1%	29.3%	37.7%	5.2%	9.6%
Benchmark	14.0%	15.7%	33.5%	35.8%	1.0%	0.0%

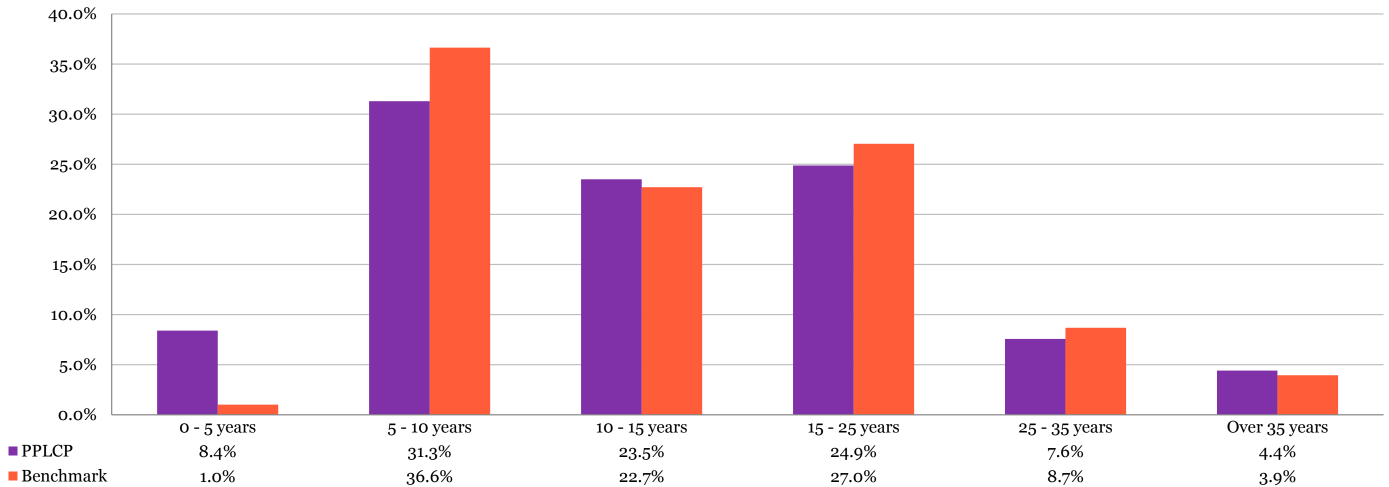
Source: *RLAM. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio.*

What we thought	What we did	What happened	Effect on portfolio
We believed lower rated credit bonds offered better value than AAA/AA rated securities.	The bias towards lower rated bonds was maintained over the quarter.	Absolute returns across investment grade credit were negative, but when adjusting for duration, lower rated issues fared better than higher rated counterparts as market sentiment remained positive, despite the bearish backdrop of rising yields for fixed income assets.	The underweight in higher rated debt had a neutral impact upon performance.
Credit ratings, while useful, are not a complete assessment of creditworthiness and value.	We maintained exposure to bonds rated below investment grade where we believed they were consistent with the overall objective of the Fund. Exposure to unrated bonds, which predominantly have investment grade risk characteristics and are in many instances secured, was broadly unchanged at 9.6%.	High yield bonds outperformed investment grade credit over the quarter, and also over the year.	Exposure to unrated and sub-investment grade bonds had a positive impact upon performance.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 4 2016

Maturity profile



	0 - 5 years	5 - 10 years	10 - 15 years	15 - 25 years	25 - 35 years	Over 35 years
PPLCP	8.4%	31.3%	23.5%	24.9%	7.6%	4.4%
Benchmark	1.0%	36.6%	22.7%	27.0%	8.7%	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 a gradual increase in UK government bond yields.	The duration of the Fund was maintained below benchmark through the quarter.	UK government bond yields rose significantly over the quarter, returning to pre-referendum levels. The increase was spurred by rising inflation expectations, and by the announcement in the Autumn Statement of £15bn additional gilt issuance before the end of the financial year.	The short duration position had a small positive impact upon relative performance.
We believed there were some attractive investment opportunities in short-dated credit, although these lie outside the Fund's benchmark.	The Fund maintained a position in short-dated credit bonds, partially reflecting the allocation to the Royal London Sterling Extra Yield Bond Fund.	Short-dated bonds outperformed over the quarter.	The short-dated bond exposure had a positive impact upon performance.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 4 2016

Ten largest holdings

	Weighting (%)
Lloyds Bank Plc 6% 2029	1.2
Innogy Finance 6.125% 2039	1.2
Commonweath Bank of Australia 3% 2026	1.1
Citigroup Inc 7.375% 2039	1.0
Annington Finance 0% 2022	1.0
Abbey National Treasury 5.75% 2026	0.9
Prudential Plc 5.7% VRN 2063	0.9
Co-operative Bank 4.75% 2021	0.9
Electricite De France 6% 2114	0.9
Finance for Residential Social Housing 8.369% 2058	0.9
Total	**10.0**

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

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Quarter 4 2016

Fund activity

- Following a spike in sterling credit issuance in the previous quarter, supply fell back to levels more in line with previous years' new issuance in the final quarter of the year, led by financials. Across sectors, the Fund participated in a number of attractively priced new issues.
- Within financials (banks and insurance), the Fund purchased a number of new issues, including a 10-year subordinated bond from diversified health insurance business **Bupa** at a credit spread of 367 basis points (bps), and senior 10-year bond from the specialist lending arm of banking group **Close Brothers**; the latter holding was later increased by switching from shorter dated bonds of the issuer. Holdings in **Credit Suisse** and **Rabobank** were switched into longer dated issues.
- Within consumer sectors, the Fund participated in a new 7-year BBB+ rated issue from high street retailer **Marks & Spencer,** purchased with a yield of 210bps over the reference government bond. The Fund also purchased a new issue from intercity coach operator **National Express** with a credit spread of 165bps. Holdings in **GlaxoSmithKline** and **British American Tobacco** were sold over the quarter.
- **Verizon**, the US telecommunications company, issued both sterling and euro denominated bonds during the quarter to fund recent acquisitions. The Fund participated in the £450m BBB+ rated 19-year issue at a yield of 155bps over UK government bonds. Elsewhere in telecommunications, exposure to **America Movil** was reduced.
- Within social housing, the Fund purchased a new A+ rated 12-year senior unsecured bond from residential property company **A2Dominion**. Proceeds of the bonds are to be used to fund development plans, split between social housing and market rents, adding approximately 1,000 homes per annum to the firm's portfolio of 36,000 properties across London and the South East. The bonds were purchased at a yield of 230bps over the reference government bond. The Fund's position in national housing association **Places for People** was increased. Elsewhere within structured and secured debt, the Fund increased its exposure to **Telereal Secured Finance**, debt secured against BT properties, as well as investment trust **Scottish Mortgage and Trust**.
- Adding to the Fund's utilities exposure, new longer dated issues were purchased from water companies **Severn Trent** and **Thames Water**. Rated BBB+ and A- respectively, both performed well post issuance, although the exceptionally attractive pricing of the Thames Water issue helped these bonds rally significantly in secondary market trading. The Fund's holding in **Wessex Water** was sold during the quarter.
- Gilts were held and traded over the quarter for duration and liquidity management.

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.

Information as at 31 December 2016 and correct at that date, unless otherwise stated. For professional investors and advisors only. This document may not be distributed to any unauthorised persons and is not suitable for retail clients. The views expressed are the authors own and do not constitute investment advice. Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested. Sub-investment grade bonds have characteristics which may result in a higher probability of default than investment grade bonds and therefore a higher risk. For funds that use derivatives, their use may be beneficial, however, they also involve specific risks. Derivatives may alter the economic exposure of a fund over time, causing it to deviate from the performance of the broader market.

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ECONOMIC & BOND MARKET REVIEW

Economic review

- The surprise election of Donald Trump was the dominant event of the quarter, boosting equity markets, inflation expectations and the US dollar. While the US Federal Reserve (Fed) delivered its much-anticipated rate increase in December, on the other side of the Atlantic, the European Central Bank (ECB) extended its quantitative easing programme beyond its original March 2017 deadline. The oil price surged following co-ordinated agreements by the Organisation of Petroleum Exporting Countries (OPEC) and non-OPEC suppliers to cut production and support pricing.
- The victory of Donald Trump in the US presidential elections was unexpected, but market turmoil was short-lived and rapidly succeeded by an upward surge. The US economy showed greater momentum in the latter half of 2016. Third-quarter GDP growth was revised up to 3.5% (annualised), while a range of business surveys suggested a post-election bounce, and the unemployment rate fell. The Fed delivered its long-expected rate rise of 25 basis points in December, signalling a further three rate increases during 2017. Bolstered by positive data, Chairman Janet Yellen confirmed that this step was 'a vote of confidence in the economy'.
- Eurozone GDP grew by 0.3% in the third quarter of 2016, with surveys pointing towards a similar rate in the fourth. Despite concerns over the Italian referendum on constitutional reform, the market impact of the 'no' vote was minimal. Of greater importance was the fragility of Italian banking system and worries over its potential to spill over into the broader eurozone financial system. The ECB announced an extension of its quantitative easing programme to the end of 2017, albeit at a reduced rate of €60bn per month, and broadened its remit to include the ability to purchase bonds with yields below the official deposit rate.
- In Japan, yen strength abated, relieving some pressures on the economy and allowing many firms to improve their 2017 forecasts. Despite the Bank of Japan's (BoJ) latest interventions, inflation has so far failed to ignite. Nevertheless, domestic data over the quarter remained firm.
- In China, data remained encouraging: consumption and investment were the main supports for growth over 2016, and the Caixin PMI manufacturing series rose in December.
- The UK economy continued to shrug off Brexit in the fourth quarter. During 2016 as a whole, its resilience was largely down to consumer spending. The housing market also remained robust, with a pick-up in mortgage approvals and house price inflation. Nevertheless, protracted political uncertainty continued to dampen 2017 growth forecasts, and to put downward pressure on sterling, with consequent expectations of higher inflation over the coming year. The Autumn Statement was muted, announcing a further £15bn of gilt issuance before the end of the financial year, with only limited plans for spending.

Bond Market Review

- **Conventional UK government bonds returned -3.43%**. Yields rose steeply in response to expectations of higher inflation and following continued resilient UK economic data, while additional gilt issuance announced in the Autumn Statement weighed on the conventional gilt market. The UK yield curve steepened, as the market priced in higher inflation expectations. UK inflation, as measured by the Consumer Price Index (CPI), rose to 1.2% year-on-year in November, its highest level for two years. Gilts outperformed US bonds but underperformed European government bonds, as the ECB extended its quantitative easing programme.
- **Index linked UK government bonds returned -2.68%.** Against a backdrop of rising yields, demand for shorter dated maturities remained robust, with yields falling by 30 basis points (bps) over the quarter, while pension fund demand continued to support longer dated maturities. Ultra-long real yields rose 8bps over the quarter. With breakeven (implied) inflation rates rising over the quarter, index linked assets outperformed conventional gilts. US real yields also rose; index linked UK government bonds outperformed both US and French counterparts and performed in line with German inflation linked bonds.
- Following a particularly strong showing for **overseas sovereign bonds** in the first half of the year, and a steady return in the third quarter, the last quarter of the year saw bonds post negative returns. The J.P. Morgan Global Government Bond Index fell by 3.6% in total return terms, producing an annual return for 2017 of 21% (in sterling terms). Continuing central bank quantitative easing in Europe and Japan maintained government bond yields at low levels. Low inflation persisted in the eurozone; as the ECB extended its quantitative easing programme and removed buying restrictions on debt yielding below the deposit rate, European government yield curves steepened dramatically, before easing back slightly into the year end. US government bonds outperformed both European and Japanese counterparts, with US bonds returning 0.81%, while the Japanese and European bonds returned -10.33% and -4.21%, respectively (in local currency terms, J.P. Morgan indices).
- **Sterling investment grade credit returned-2.58%**, yet outperformed UK government bonds in absolute terms, despite posting one of its lowest quarterly returns for several years. As bond yields rose, average sterling investment grade credit spreads widened by 5bps to 123bps, but remain close to the lows that followed the BoE's August rate cut. After a busy third quarter, investment grade sterling bond issuance declined in the final quarter, returning to levels more in line with previous years. Issuance was led by the financial and industrial sectors.
- **Global high yield** bonds outperformed sterling investment grade credit, returning 1.16% (BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained, 100% hedged to sterling). Europe was the strongest performing region, followed by the US and the UK. Emerging markets lagged, suffering under the effect of a stronger US dollar. In a subdued quarter for high yield returns, the recurring positive themes were the increase in oil price, stronger growth expectations in the US and continued monetary support in Europe. Periods of risk aversion in the run-up to the US election in November and following the Fed's December increase in rates and hawkish comments had a negative impact. Further challenges stemmed from the substantial outflows experienced during November.

ROYAL LONDON

INVESTMENT OUTLOOK

Key points

- We expect greater momentum in the global economy during 2017, with US growth picking up and growth in China and the eurozone remaining close to 2016 rates.
- We expect UK GDP growth to slow in 2017 as the economy navigates the uncertainty of Brexit negotiations. We expect UK CPI inflation to rise above target during the year.
- We expect the central banks of the UK, Japan and Europe to retain their biases towards policy easing, while in the US we anticipate three further rate rises in 2017.

Global economic growth prospects

- The outlook for the US largely depends on the size and composition of any fiscal stimulus package from the Trump administration, and upon how far the new administration translates sceptical rhetoric on current global trade arrangements and global security into actual policies. We expect the Fed to continue to raise rates during 2017, but that they will be wary of both excessive dollar appreciation and the impact on mortgage rates. There are clear upside risks to the pace of rate increases.
- In the UK, our base case is for growth to be slower in 2017 than 2016, as household real income growth weakens and corporate investment is impacted by uncertainty. Access to EU markets could be materially reduced for UK firms, which would restrain business activity and supply growth. We expect global growth to improve in 2017, which should limit the downside to the UK. We have assumed weaker growth, rather than recession, as a base case. We expect CPI inflation to rise in 2017.
- In the eurozone, with rising political risks ahead, economic growth remains tepid and inflation is still too low. Fiscal policy across the region should provide some support and corporate lending conditions have improved, but there is no sense that the economy has reached 'escape velocity', with GDP growth moving towards 2%, year on year. The boost from cheaper energy in the eurozone (a large net energy importer) is now waning, with headline inflation set to rise, squeezing still modest nominal income growth and consumer demand. Elections in a number of core countries have potential to spark bouts of volatility.
- In China, the most recent economic data suggest that GDP will easily meet the authorities' target for growth of 6.5-7% in 2016. We expect growth to remain steady, and for tighter capital controls to ensue in order to stem outflows, as US dollar strength increases pressure on the renminbi. While the impact of the 2015/16 stimulus will wane, we would not expect growth to slow materially during 2017.
- In Japan, we think the BoJ will retain its bias towards monetary easing. Japan is well placed to benefit from a strong dollar and an increase in global growth, and support from domestic monetary and fiscal policy should continue to boost the economy.

Outlook

- We expect global government bond yields to rise gradually over the next 12 months, as the inflation outlook and global growth picks up. We expect the Fed to raise rates three times in 2017.
- Our central case is for **UK government bond** yields across maturities to rise over 2017, and for the yield curve to steepen marginally, although we expect some volatility.
- For **index linked bonds**, we think long-term real interest rates in the UK are too low, and do not reflect long-term fundamentals. Pension fund demand for longer dated, real yield securities remains strong, but has become more sporadic and tied to supply events. We believe global inflation linked bonds offer better value, with the real yields of European and US bonds higher than their UK counterparts. We think that 5- and 10-year breakeven (implied) inflation rates now look fair value on a longer term view, while long-dated breakeven rates appear to be above fair value. Heavy index linked and gilt supply in the first quarter is likely to put pressure on UK yields.
- In **overseas bond markets**, we believe the global economy will to continue to grow over the near term. Political risks in Europe will be greater in 2017 on account of forthcoming elections, and volatility around these events is likely to present trading opportunities. We consider developed market government bonds to be expensive.
- We expect that **investment grade credit** will outperform UK government securities over the next three years. We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence. We consider that the current credit spread premium, over UK government bonds yields, is adequate compensation for default and other risks (e.g. liquidity and rating migration).
- 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 growth and rate environment provides a moderate albeit rising default climate, with ongoing refinancing opportunities.

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.

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

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Company news

Quarterly results showed that Royal London Asset Management (RLAM) continued to perform well. In the year to 30 September 2016, RLAM attracted external new year-to-date inflows of £4.8bn (30 September 2015: £2.5bn). This was largely due to a significant increase in Institutional flows into RLAM's fixed income range. The combination of new business flows, as well as rising markets, meant that RLAM's assets under management exceeded £100 billion for the first time.

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GLOSSARY

ABS – Asset Backed Securities. Debt secured against assets of the issuer. Subsectors of ABSs include mortgage backed securities (MBS), which can be residential (RMBS) or commercial (CMBS).

Amortisation – incremental repayment of a bond over its lifetime.

Attribution –measurement of a fund's return versus its benchmark return, breaking up the active performance into component parts, such as the impact of stock selection, asset allocation (between different asset classes), yield curve positioning (for fixed income portfolios) and duration (for fixed income portfolios).

Basis point – 1 basis point = 0.0001

Benchmark – an index or other market measurement used 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. 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.

Breakeven rates – the level of inflation required to make the return on index linked bonds equal to return on conventional bonds of similar maturity. Effectively, the price of the breakeven rate is the price investors are willing to pay for inflation protection, and is therefore an indicator of inflation expectations.

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

CD - Certificate of Deposit**.** 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 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.

CDS – Credit Default Swap. 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.

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 in bond documentation that place restrictions on the issuer.

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

CPI - Consumer Price Index. An inflation indicator, calculated as the weighted average price of consumer goods and services.

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 – the difference in yield between a corporate bond yield and a reference government bond yield.

Cyclicals – sectors 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.

Defensives – sectors that are less sensitive to the economic cycle.

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.

Duration –sensitivity of a bond's price to changes in interest rates. Duration 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.

Ex ante – expected

Ex post - historic

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.

Future – an exchange-traded 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.

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. 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.

LDI – Liability Driven Investment. Investing in order to match asset cash flows to liability cash flows.

Market value –the price at which a security can be bought in the market on the date specified.

Maturity – the final payment date of a bond on which the principal and final coupon are repaid.

Monoline insurance – credit insurance of lower rated bonds, provided by guaranteeing the payment of coupon and principal of the underlying bonds in return for premium payments. Most of these 'credit wrapped' bonds are now rated according to the underlying credit quality of the issue rather than the monoline's rating.

Nominal value – Also known as the face value: the price of a security at the time of issuance.

PFI – Private Finance Initiative. Projects that involve the provision of assets for the public sector by private companies.
Quantitative easing – A type of monetary policy employed by central banks to stimulate an economy by creating new money to purchase government bonds. .

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 split into tranches, 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'.

Supranationals – international non-government agencies or 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. Common swaps include interest rates, inflation or currency.

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

Tracking error – a measure which expresses how closely a portfolio's return pattern matches that of its benchmark index. It is calculated 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. It is used as both an *ex post* (historic) and *ex ante* (expected) measure.
Underwriting – the process of guaranteeing the new issue of securities.

Unrated bonds – bonds that are not rated by any of the rating agencies. RLAM assigns an internal rating to the unrated bonds in which it invests.

Yield – the 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.

Royal London Asset Management is a marketing group which includes the following companies:

Royal London Asset Management Limited provides investment management services, registered in England and Wales number 2244297; Royal London Unit Trust Managers Limited manages collective investment schemes, registered in England and Wales number 2372439. RLUM (CIS) Limited, registered in England and Wales number 2369965. All of these companies are authorised and regulated by the Financial Conduct Authority.

Royal London Pooled Pensions Company Limited provides pension services, authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, registered in Scotland number SC048729.

All of these companies are subsidiaries of The Royal London Mutual Insurance Society Limited, registered in England and Wales number 99064. Registered Office: 55 Gracechurch Street, London, EC3V 0RL. The marketing brand also includes Royal London Asset Management Bond Funds Plc, an umbrella company with segregated liability between sub-funds, authorised and regulated by the Central Bank of Ireland, registered in Ireland number 364259. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland.

Financial Statements

Portfolio Valuation

Trading Statement

Portfolio Valuation

As at 31 December 2016

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										
	134,404,252	GB00B1ZB3X88	RLPPC Over 5 Year Corp Bond Pen Fd	2.26375	169,095,010.51	304,257,625.79	0.00	304,257,625.79	0	100.0
				Funds Held total	**169,095,010.51**	**304,257,625.79**	**0.00**	**304,257,625.79**		**100.0**
				Grand total	**169,095,010.51**	**304,257,625.79**	**0.00**	**304,257,625.79**		**100.0**

Trading Statement

For period 01 October 2016 to 31 December 2016

Dorset County Pension Fund

	Trade Date	Transaction Type	Nominal	Security	Price (£)	Book Cost (£)
Acquisitions						
Funds Held						
	04 Oct 2016	Acquisition	150,639.93	RLPPC Over 5 Year Corp Bond Pen Fd	2.36	355,796.46
	06 Oct 2016	Acquisition Rebate	103,018.70	RLPPC Over 5 Year Corp Bond Pen Fd	2.32	238,781.90
					Funds Held total	**594,578.36**
					Acquisitions total	**594,578.36**