Dorset County Pension Fund

Insight mandate investment update at 30 September 2017

Our understanding of the Fund's objectives and strategy

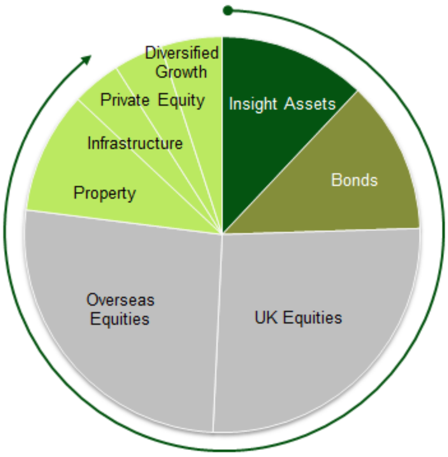
Funding objectives and policy

- 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.£2.74bn at 31 March 2017)



Source: Dorset County Pension Fund.

Performance to 30 September 2017

	3 months		12 months		Since inception	
	%	£	%	£	% p.a.	£ cum.
Portfolio	-0.63	-1,635,333	6.89	19,274,117	14.09	135,630,770
Benchmark	-1.16	-3,196,767	3.05	8,313,515	12.83	122,249,036
Relative	**0.54**	**1,561,433**	**3.84**	**10,960,602**	**1.26**	**13,381,734**

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 -0.29% as a proportion of the value of the inflation exposure hedged and the portfolio return was -0.15% 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: 38% (based on 31 March 2017 total Fund asset value)

Collateral position

- Leverage ratio stood at 2.8x at 30 September 2017. This is based on the present value of liabilities covered by the inflation hedge of £1,053.3m and a portfolio value of £371.0m.
- Collateral stress tests: a 0.2% fall in inflation expectations (swap RPI rates) would reduce the value of the portfolio by c.£41m and a 0.6% fall in inflation expectations would reduce the value of the portfolio by c.£117m.

Portfolio valuation and hedge characteristics as at 30 September 2017

	Value	Interest rate sensitivity (PV01[1])		Inflation sensitivity (IE01[2])	
	£m	£k	% of benchmark	£k	% of benchmark
Conventional gilts	177.0	-285	39.3	0	0.0
Index-linked gilts	293.6	-755	103.9	741	34.9
Futures	2.0	68	-9.4	0	0.0
Interest rate swaps	-92.1	353	-48.7	0	0.0
RPI swaps	27.3	-109	15.0	1,369	64.5
Repurchase agreements	-58.7	0	0.0	0	0.0
Network Rail bonds	3.9	-10	1.4	10	0.5
Insight Libor Plus Fund	12.5	0	0.0	0	0.0
Liquidity	5.5	0	0.0	0	0.0
Total assets	**371.0**	**-738**	**101.6**	**2,121**	**99.9**
Liability benchmark	**271.9**	**-726**	**100.0**	**2,123**	**100.0**

[*]The value of the inflation exposure hedged is c.£1,053.3m

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

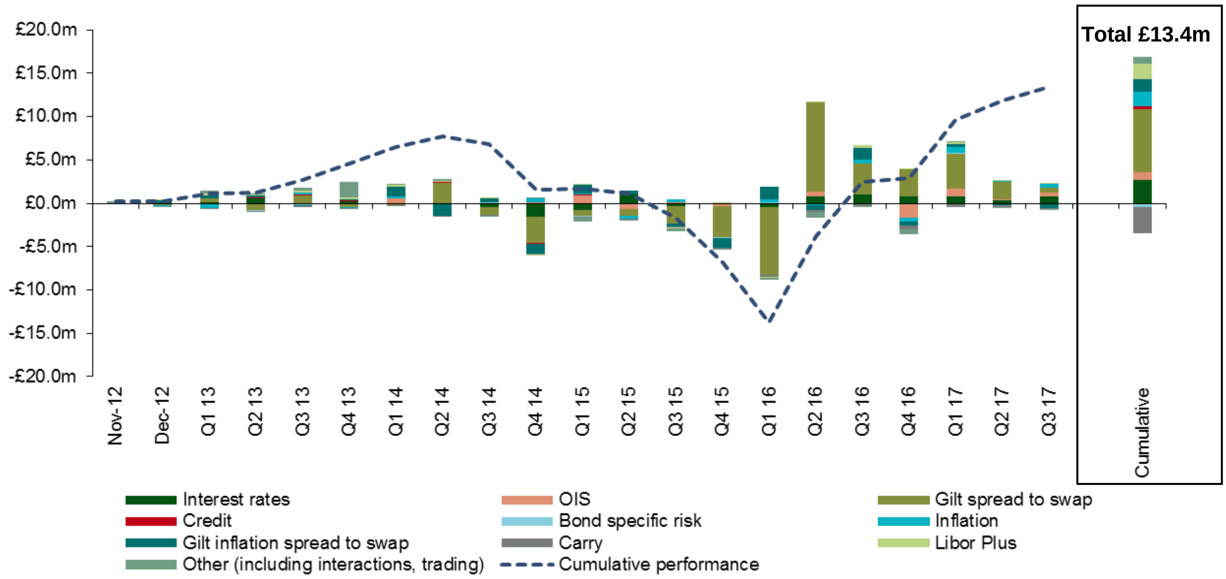
[2] IE01: change in present value of a series of future cash flows resulting from a 0.01% shift in the relevant inflation expectation curve.

Performance commentary

- Benchmark performance in the third quarter of 2017 was driven by a slight fall in cost of inflation protection through swaps combined with slightly higher gilt yields. The 20 year RPI swap rate ended the quarter at 3.52% and the 20 year yield on index-linked gilts was at -1.52%.
- The portfolio outperformed the benchmark return over the quarter, with the most material benefits arising from further tightening in z-spreads (yields on selected gilts contracted over the quarter relative to swaps) and also a widening in the basis between SONIA and 3 month LIBOR swaps relative to 6 month LIBOR swaps.

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	2.7	2.6
OIS	0.4	-0.2	1.0
Gilt Spread to Swap	0.5	9.7	7.2
Credit	0.0	0.0	0.4
Bond Specific Risk	0.0	0.1	-0.5
Inflation	0.4	0.7	1.7
Gilt Inflation Spread To Swap	-0.5	-0.7	1.4
Carry	-0.1	-1.2	-3.0
Libor Plus Fund	0.1	0.4	1.8
Other	0.0	-0.6	0.7
Relative performance	1.6	10.9	13.4

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.