ASSET MANAGEMENT

DORSET COUNTY PENSION FUND

Quarterly Report 30 June 2018

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PORTFOLIO REVIEW

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

Fund & 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)
30 June 2018	**204.07**
31 March 2018	204.50
Change over the quarter	(0.43)
Net cash inflow (outflow)	0.00

Executive summary

Performance

- The Fund gave a gross return of -0.21% over the quarter, compared with a benchmark return of -0.42%.
- Sterling investment grade credit spreads widened during the quarter as a whole. This chiefly reflected substantial underperformance by credit in May, as volatility stemming from Italy's political crisis rippled through markets, deterring investors from taking on risk and sapping demand for corporate bonds. The average sterling investment grade credit spread ended the quarter 10 basis points (bps) wider at 1.24%. Spreads widened across the sterling credit market, led by subordinated insurance debt; supranationals, covered bonds and asset-backed securities were the strongest performers.
- Fund returns were negative for the quarter, but ahead of benchmark. Stock selection within secured and structured debt was the main positive for the Fund over the quarter, more than offsetting the negative impact of the underweight allocation to supranationals and overweight in financials.

The economy & bond markets

- Global growth is cooling off. Our global growth scorecard – based on central bank policy, leading indicators, business confidence and consensus GDP forecasts– has turned negative for the first time since September 2016. China has been slowing all year, UK growth is sluggish, and growth has come off the boil in Europe. Only US growth remains strong, helped by President Trump's late cycle fiscal stimulus.
- The upturn in headline inflation relates mainly to oil price strength on the back of declining inventories, supply disruption and heightened tensions in the Middle East. Unemployment rates are low all over the world, but so far, wage inflation is increasing only gradually.
- The political crisis in Italy, where the parliamentary election had proved inconclusive, dominated bond markets in the second quarter. The prospect of a second election caused a significant 'risk-off' move in global markets. Sterling investment grade credit underperformed UK conventional government bonds but outperformed index linked bonds. Benchmark ten-year gilt yields fell slightly over the period, while the average sterling investment grade credit spread widened by 10 basis points (bps) to 1.24%.

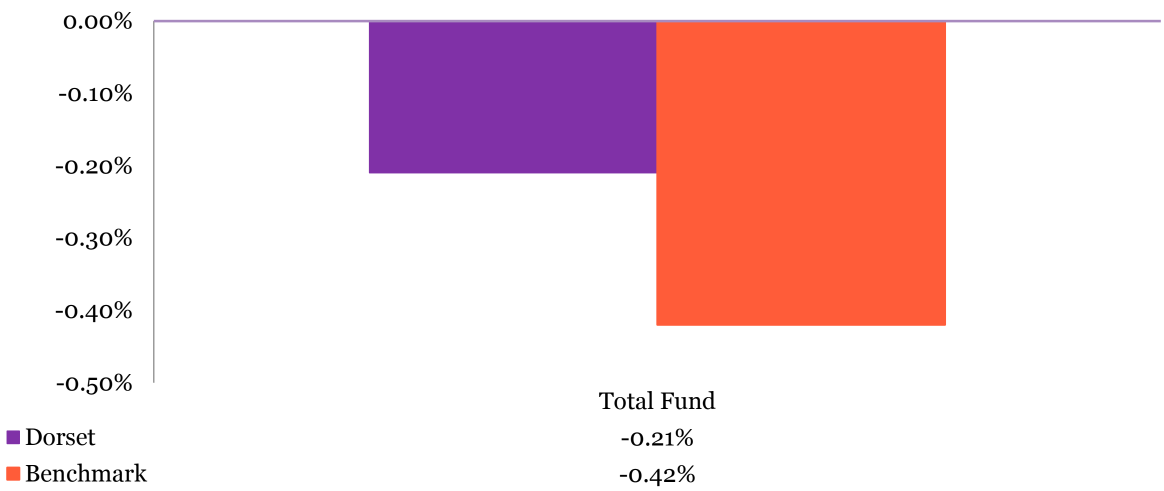
Investment outlook

- While Brexit talks have progressed, we believe that UK business investment will be constrained by uncertainty. We also expect consumer spending to be impacted by the ongoing squeeze in real incomes, although the pressure is easing as inflation slows.
- We anticipate one rate hike by the Bank of England in 2018, along with four rises by the US Federal Reserve. The European Central Bank has announced that its programme of monthly asset purchases will end after December, although rates are likely to stay on hold until summer 2019.

FUND PERFORMANCE

Performance

	Fund (%)	Benchmark* (%)	Relative (%)
Q2 2018	-0.21	-0.42	0.21
Rolling 12 months	2.18	0.61	1.57
3 years p.a.	6.88	6.06	0.82
5 years p.a.	7.91	6.85	1.06
10 years p.a.	9.78	8.91	0.87
Since inception 02.07.2007	8.64	8.59	0.05



Source: RLAM, gross of standard management fees.

**Benchmark: iBoxx Sterling Non-Gilt Over 5 Year Index.*

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Asset split

	Fund (%)	Benchmark[1] (%)
Conventional credit bonds[2]	99.8	98.8
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	0.0	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	10.2 years	10.4 years
Gross redemption yield[3]	3.24%	2.71%
No. of stocks	232	690
Fund size	£280.2m	-

Source: RLAM. Launch date: 20.07.2007.

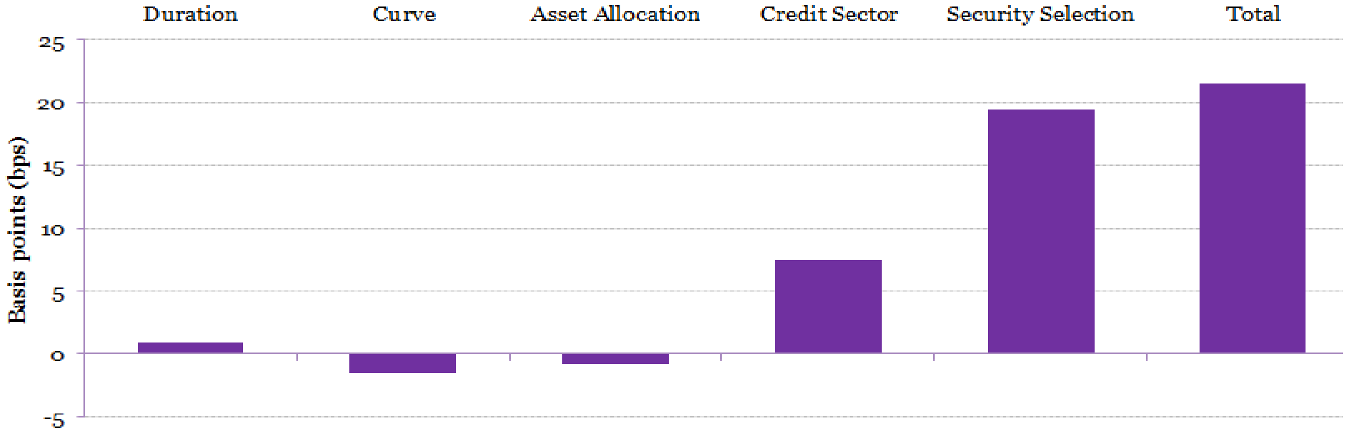
[1]Benchmark: iBoxx Sterling Non-Gilt Over 5 Year Index.

[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.

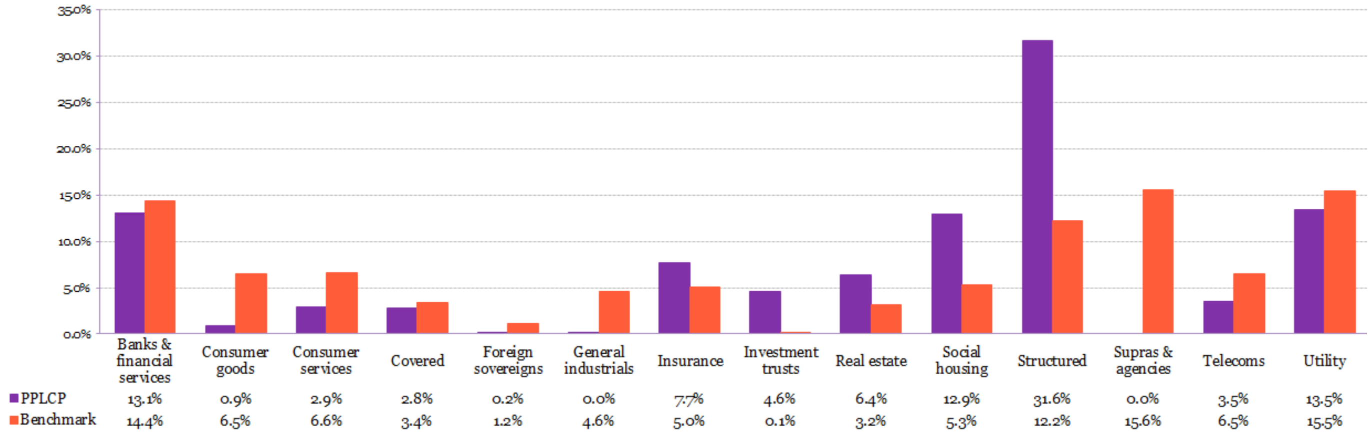
Performance attribution for quarter 2 2018



Source: RLAM and UBS Delta. The above performance attribution is an estimate. Please note that the attribution chart does not include residual effect returns.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Sector breakdown

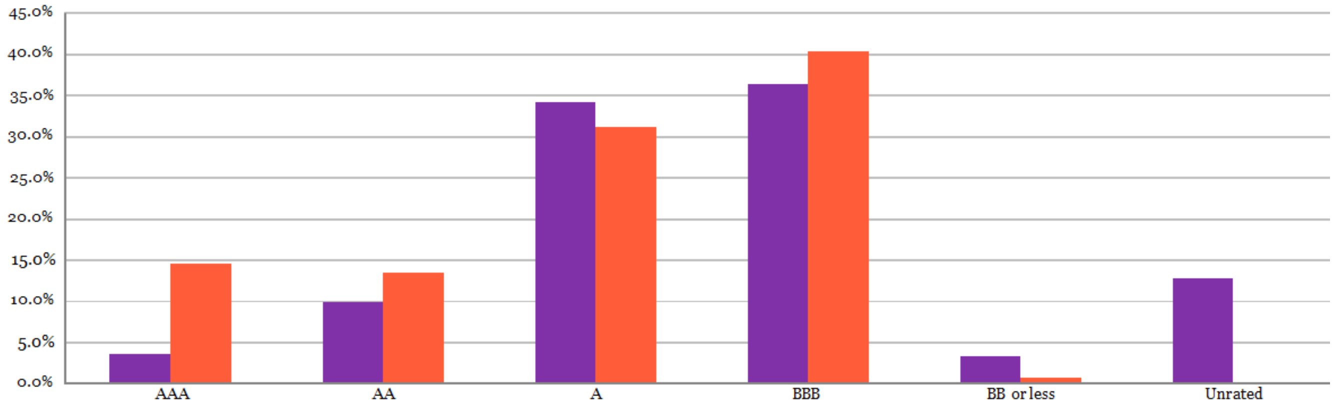


Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio.

What we thought	What we did	What happened	Effect on portfolio
We expected that corporate bonds would outperform supranational debt.	The fund had no exposure to supranational debt during the quarter.	Supranational debt outperformed the wider sterling credit market for a second quarter in a row as a 'risk off' mood among investors in the latter half of the period curbed demand for corporate bonds.	The fund's lack of exposure to supranationals was disadvantageous for relative performance.
We continued to see value in financials (banks and insurers), and to favour a combination of covered bonds and subordinated bank debt over senior bonds.	The allocation to financials was modestly above benchmark throughout the quarter. Within this holding, we retained the underweight exposure to senior unsecured debt, offset by overweight exposure to subordinated debt. Exposure to covered bonds was broadly maintained in line with the benchmark.	Financial bonds delivered a robust return in April, led by subordinated debt. However, these issues performed very poorly in May amid diminished investor appetite for risk, and lagged behind the broader market for the quarter as a whole. Covered bonds outperformed the broader market.	The overweight allocation to financial bonds and the preference for subordinated debt had a negative effect on performance. Exposure to covered bonds was supportive.
We thought that high-profile, consumer-orientated bonds and industrials were unattractively priced, relative to other sectors.	We maintained the underweight allocations to industrial and consumer sectors.	Consumer sectors delivered mixed returns; while auto, retail and consumer goods bonds outperformed the broad market, being less affected by rising yields, media underperformed. Industrials lagged modestly behind the wider credit market.	The low weightings in consumer and industrial sectors did not have a material effect upon relative performance.
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.	Secured and structured sectors, which typically comprise longer dated bonds and span a wide spectrum of industries, outperformed modestly over the quarter as a whole, driven by a robust return from ABS.	The fund benefited from stock selection within secured and structured debt over the quarter. This was the main driver of relative outperformance in the quarter.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Rating breakdown



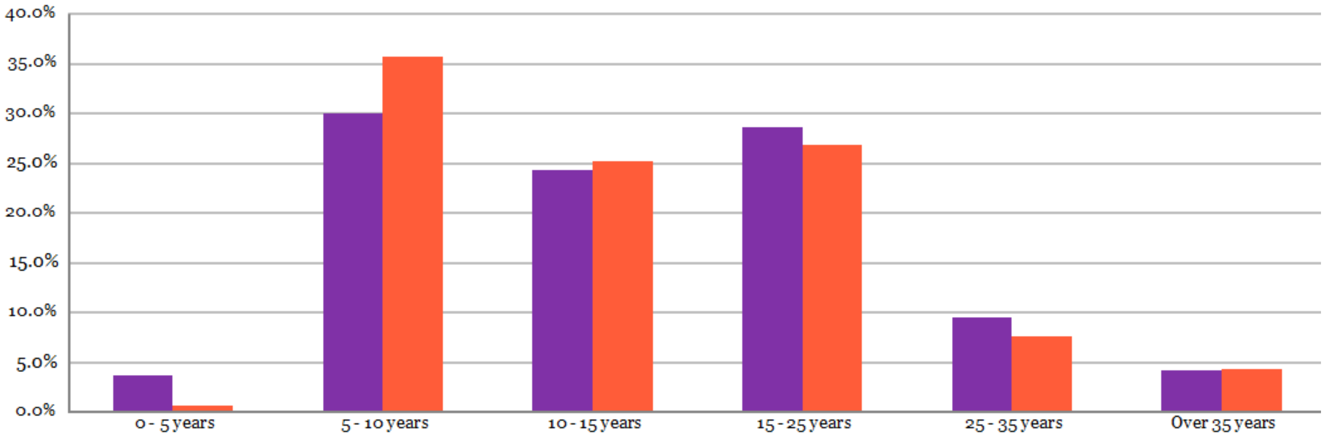
	AAA	AA	A	BBB	BB or less	Unrated
PPLCP	3.6%	9.9%	34.1%	36.4%	3.3%	12.8%
Benchmark	14.6%	13.4%	31.1%	40.3%	0.6%	0.0%

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.	Lower rated debt outperformed AAA rated and AA rated bonds in April, but subsequently lagged behind for the rest of the quarter and the period as a whole amid weaker investor appetite for risk.	The preference for lower rated debt had a negative effect on relative performance for the entire quarter.
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. In part, this reflected the fund's holding in the Royal London Sterling Extra Yield Bond Fund, which accounted for a nominal portion of assets at the start of the quarter and was sold during the period. Exposure to unrated bonds, which predominantly have investment grade risk characteristics and are in many instances secured, was broadly unchanged.	High yield bonds underperformed investment grade credit for the quarter as a whole. The Royal London Sterling Extra Yield Bond Fund posted a gross return of 1.54% over the quarter, compared with the -0.15% return for the broader investment grade sterling credit market. Unrated bonds, which consist mainly of secured and structured issues, outperformed.	The holding of sub-investment grade debt detracted modestly from returns. The allocation to the Royal London Sterling Extra Yield Bond Fund did not have a material effect upon performance. Exposure to unrated bonds had a small positive impact upon relative performance over the quarter.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Maturity profile



	0 - 5 years	5 - 10 years	10 - 15 years	15 - 25 years	25 - 35 years	Over 35 years
PPLCP	3.6%	29.9%	24.3%	28.6%	9.4%	4.2%
Benchmark	0.6%	35.6%	25.1%	26.9%	7.6%	4.2%

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 fund's short duration stance versus the benchmark was broadly maintained over the quarter.	Yields on benchmark 10-year gilts fell 7 basis points (bps) for the quarter as a whole, reflecting a sharp drop in May and small rises in the period's other months.	The short duration position did not have a material effect upon relative performance.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Ten largest holdings

	Weighting (%)
Innogy Finance 6.125% 2039	1.5
Finance for Residential Social Housing 8.368% 2058	1.2
HSBC Bank 5.375% 2033	1.2
Barclays Plc 3.25% 2033	1.1
Lloyds Bank Plc 6% 2029	1.1
Aviva Plc 6.125% 2036	1.0
SL Aberdeen 6.75% VRN Perpetual	1.0
Citigroup Inc 7.375% 2039	1.0
ENEL Finance 5.75% 2040	1.0
Equity Release 5.7% 2031	1.0
Total	**11.1**

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

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Fund activity

- Sterling credit issuance slowed modestly in the second quarter from the prior three months, held back by a sharp drop in May. For the first half of 2018, issuance declined by about a fifth from the prior year.
- The fund increased its exposure to secured and structured issues by a small amount during the quarter and reduced holdings of telecommunications and utility bonds moderately.
- The fund bought debt of **Grainger**, the UK's largest publicly traded residential landlord, which issued a benchmark 10-year senior bond at a spread of 187bps over gilt yields in order to redeem existing debt. In social housing, purchases included 30-year issues from **Clarion Housing Group**, the largest UK organisation in the sector, launched at a spread of 137bps over gilts; **Bromford Housing Group**, at 135bps over gilts; and **Orbit Group**, at 160bps over gilts. The fund also participated in social housing organisation **Libra Longhurst**'s sale of 25-year bonds at 148bps over gilts and **Aster Group**'s tap of an existing 2043 issue.
- Elsewhere in new issues, supply from the financial sector remained ample, including the bond market debut of insurer **Hastings Group**, which sold seven-year senior debt at a spread of 180bps over gilts; the issue held up relatively well in secondary trading, and the holding was subsequently sold at a profit. The fund also bought senior bonds of **Virgin Money** and merchant bank **Close Brothers**, along with subordinated debt of **Leeds Building Society**.
- In the secondary market, holdings including utility **WoDS Transmission**, financial **Bank of America** and transport company **National Express Group** were sold to manage cash. An exposure to telecommunications company **AT&T** was expanded to replace an allocation that was called away from the portfolio. Within financials, the fund partially switched a holding of **Wells Fargo**'s subordinated bonds into senior debt of **Citigroup** to reflect the manager's risk preference and initiated a position in subordinated debt of **Rabobank**.
- The holding of **AT&T** referenced above was redeemed by the issuer at a price of 101 after the takeover of Time Warner failed to meet a deadline for completion in April.

Key views within the 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 gradually trend higher over 2018.
- 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.

FIXED INCOME ESG ACTIVITY REPORT

Grosvenor Group – Unrated Grosvenor bonds have long been a core holding of RLAM credit portfolios, offering an attractive combination of security over high quality collateral, protective covenants and above benchmark income. An element of this evaluation recognised that these characteristics must adequately mitigate the lack of external bond rating and the more limited disclosure that is typical of private company bond issuers. Indeed, based on RLAM's previous sustainability research, Grosvenor has scored badly on traditional governance and environmental disclosure concerns.

As a consequence of making contact with the group as part of RLAM's broader MEES project (as discussed in previous FI ESG activity reports), we were able to spend time with Grosvenor Group's treasury and operations teams discussing the company's environmental philosophy and the initiatives they are undertaking to ensure the longevity of their asset base. Through our discussions it became apparent that Grosvenor's historic disclosure was underselling the practical impact of their environmental and social initiatives and a clear focus on the sustainability of their estate. For instance, they have received the first BREAM 'outstanding' award for a listed building and completed the first privately rented residence in London to achieve 'Enerphit Passivhaus', meaning that less than 10w per metre of living space is required to heat the building. These achievements allow Grosvenor to demonstrate the economic feasibility of improving energy efficiency of listed buildings while still retaining the character of their buildings; this is critical given the legacy nature of a large proportion of Grosvenor's estate.

Constructive engagement improving our understanding of the social and environmental sustainability of collateral supporting our long-term financing can only further enhance our evaluation of the risks and opportunities of this important investment. Additionally, this interaction further demonstrates the broad benefits of thematic collaborations between RLAM's Fixed Income and ESG teams. The MEES project, in particular, has enhanced our understanding of the environmental risks our property and secured issuers face. It has enabled more effective evaluation of the mitigation we require as debt investors, and, as in the case of Grosvenor, has provided a focused forum for improved engagement with borrowers that, hitherto, may have been more reticent with their disclosure.

Grainger Plc - During the quarter, we participated in the new issue, Grainger PLC. Grainger is the UK's largest listed residential landlord and owns and manages around 9,000 homes. As part of our initial due diligence of the company, we will use third party provision of ESG data to supplement our evaluation where appropriate. However, in this instance, a report had flagged the company for potential concerns regarding revenue recognition and asset-liability valuation ratios. As our internal analysis had not noted these attributes as indicating high risk, we scheduled a call with the provider to discuss the origins of their concerns. During this call, it became apparent that the data was being calculated incorrectly. Our ESG team was able to discount these erroneous risk indications and provide an ESG analysis based on first principles. We believe this experience further highlights the significant advantage of 'in-house' ESG capability, enabling more effective and integrated evaluations of credit risk, as well as greater scrutiny of third party assessments.

Thames Tideway Tunnel – The Thames Tideway Tunnel is a significant infrastructure project building a super sewer under the River Thames that is seeking to prevent sewage being pumped into the river whenever London's sewers overflow. We believe Tideway's labelled Green bonds are attractive, offering genuine green credentials, as well as meaningful credit protections for lenders. Indeed, the environmental efficacy of these bonds provides a useful benchmark against which more conventional, and often more superficial, Green bonds should be assessed.

Tideway management recently held a bondholder update, which provided a good opportunity to engage with senior management, covering a financial review and progress against project plans. It also gave a unique opportunity to see the two giant boring machines before they are put in the ground and begin their 25km journey underneath the Thames.

For further details see our Bonds and Beyond blog:

https://www.rlam.co.uk/Home/Institutional-Investor/Our-views/Our-thinking/RLAM-participates-in-historic-green-infrastructure-project/

ESG in the Water Sector - We recently concluded a project assessing ESG performance across the UK water sector, identifying its potential impact on credit portfolios. As a primarily privately owned sector, the UK water industry represents a good opportunity for targeted ESG and credit analysis. This research expands on previous work we have undertaken in the sector focused on climate change resilience and considers a broader variety of social and environmental measures for their impact on credit quality. We found that sound ESG management – or 'operationalised sustainability' - leads to less volatile and marginally higher profitability, stronger climate resilience and greater social performance. Whilst the regulatory framework provides significant comfort for lenders, we can incorporate this additional information into our long-term investment decisions, taking into account the differing risk each utility faces, as well as the potentially divergent impact on different parts of the issuers' capital structures.

FIXED INCOME ESG ACTIVITY REPORT

You can access the full report here:

https://www.rlam.co.uk/Documents-RLAM/Articles/Assessing%20ESG%20performance%20across%20the%20UK%20water%20sector%20and%20its%20impact%20on%20credit%20portfolios%20-%20Gail%20Counihan%20and%20Matt%20Franklin%20FINAL%20anonymised.pdf

Cayman Island Entities - Following public pressure and engagement from debt investors, both Yorkshire and Thames Water sought to move their financing entities from the Cayman Islands to the UK. Due to the significant lender protections within our Yorkshire and Thames bonds, bondholder consent was required for this move to occur. Given the complex nature of the process, both water companies offered a work fee to cover the significant investor focus required. Following a detailed review, we believe the proposals will not have an impact on the credit quality of the companies, yet will remove a key source of public scepticism, and voted in favour of the substitutions. These motions have since passed, with both water companies now in the process of moving their financing entities to the UK.

We were particularly pleased to see this development. As discussed in recent integration reports, we recently met with management and highlighted how corporate structures can be simplified whilst still retaining the significant protections and controls in place for the benefit of bondholders. This is reflective of our attempts to target our borrower engagement to sectors where debt stakeholders' influence can go beyond traditional limitations.

Housing Association lending - RLAM continues to support the Social Housing sector, and with private funding becoming increasingly important for the delivery of new affordable housing in the UK, we were pleased to purchase a debut issue from the South West and Midlands operator, Bromford Housing Association. In addition, we extended funding to existing issuers, Clarion Housing Group, Longhurst Housing Association and Orbit Group, a collection of social housing providers that reflects the nationwide breadth of our clients' financing provision to the sector.

We remain committed funders to the sector within a disciplined lending framework, reflecting security, portfolio diversification and setting the appropriate return required for the risk to the sector's creditors.

FURTHER INFORMATION

Market commentaries & investment outlook

Please click on link for further information.

Corporate governance & compliance

Please click on link for further information.

Glossary

Please click on link for a glossary on terms.

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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'.

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IMPORTANT INFORMATION

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Financial promotion issued by Royal London Asset Management April 2018. Information correct at that date unless otherwise stated.

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55 Gracechurch Street, London, EC3V 0RL.

Financial Statements

Portfolio Valuation

Trading Statement

Portfolio Valuation

As at 30 June 2018

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										
	85,038,461	GB00B1ZB3X88	RLPPC Over 5 Year Corp Bond Pen Fd	2.39977	107,440,443.10	204,072,747.04	0.00	204,072,747.04	0	100.0
				Funds Held total	**107,440,443.10**	**204,072,747.04**	**0.00**	**204,072,747.04**		**100.0**
				Grand total	**107,440,443.10**	**204,072,747.04**	**0.00**	**204,072,747.04**		**100.0**

Trading Statement

For period 01 April 2018 to 30 June 2018

Dorset County Pension Fund

	Trade Date	Transaction Type	Nominal	Security	Price (£)	Book Cost (£)
Acquisitions						
Funds Held						
	06 Apr 2018	Acquisition Rebate	62,659.32	RLPPC Over 5 Year Corp Bond Pen Fd	2.42	151,832.93
					Funds Held total	**151,832.93**
					Acquisitions total	**151,832.93**