ASSET MANAGEMENT

DORSET COUNTY PENSION FUND

Quarterly Report 30 September 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 September 2018	**203.19**
30 June 2018	204.07
Change over the quarter	(0.88)
Net cash inflow (outflow)	0.00

Executive summary

Performance

- The Fund gave a gross return of-0.43% over the quarter, compared with a benchmark return of -0.57%.
- The average sterling investment grade credit spread narrowed modestly to 1.20% during the quarter. Revived investor risk appetite and sustained strength in company earnings supported demand for corporate debt, while UK government bonds struggled against a backdrop of anticipated monetary policy tightening, rising inflation and weakness in sterling.
- The Fund outperformed the broader sterling credit market, with performance driven by our positioning in financials and underweight in supranationals.

The economy & bond markets

- While still solid, global growth seems at best to be drifting sideways. However, policy support for the global economy is substantial in 2018, including still accommodative monetary policies. Although headline inflation is picking up in many countries following the rise in oil prices, core inflation still looks relatively well behaved and seems particularly subdued in the eurozone and Japan. The risk of global recession in 2018 and into 2019 is low, but there are a few red lights flashing, such as prospects of increased protectionism and tight labour markets in many economies.
- The UK economy seems likely to feel some further impact from Brexit over the remainder of 2018, with the outcome still unclear and political uncertainty heightened. In particular, we expect business investment to be relatively subdued in the rest of 2018. Our base case is that a withdrawal deal will be reached and ratified by March 2019 or soon after.
- Sterling investment grade credit outperformed UK government debt in the third quarter – respective all-maturities returns were -0.36% and -1.73% – after lagging behind in the first half of 2018. Revived investor appetite for risk and sustained strength in corporate earnings supported credit demand, while gilts struggled against a backdrop of anticipated monetary policy tightening, rebounding inflation and a weaker pound.

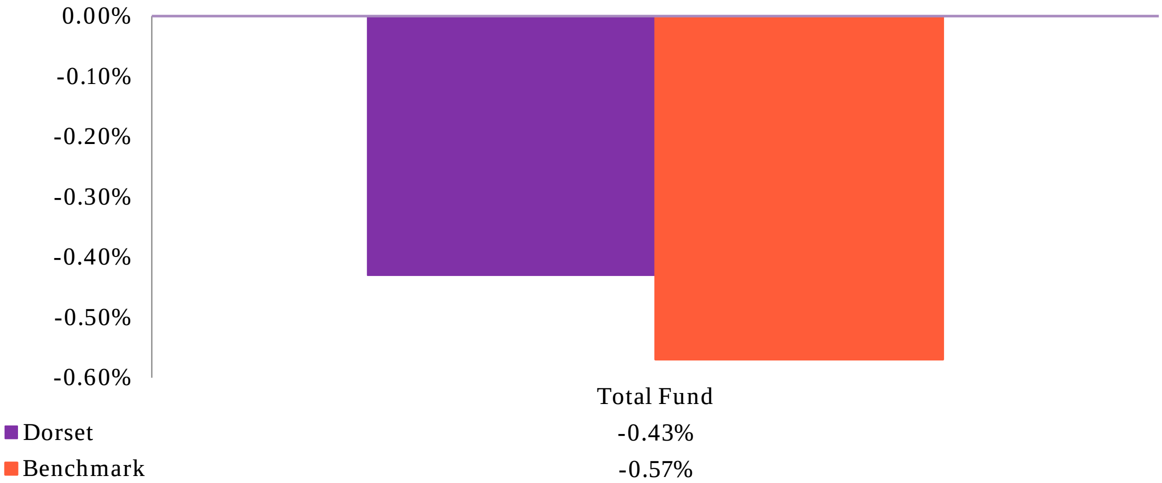
Investment outlook

- Our base case is for world growth to remain in a range of 3.5% to 4%, slowing on average as the cycle matures in several major economies and policy support fades. We expect inflation pressures to pick up, while remaining limited, avoiding any need for sharp and widespread monetary tightening.
- The probability of recession seems low for now, with little indication that growth might weaken sharply. However, downside risks have risen: trade tensions are high; monetary policy is tightening; oil prices are up sharply versus a year ago; and Brexit is approaching.
- We anticipate more (gradual) rate rises by the Fed, with one further increase in 2018 and three in 2019. We expect the Bank of England (BoE) to leave rates unchanged into 2019, and no hikes by the European Central Bank before the second half of next year. The People's Bank of China remains ready to ease on any signs of a significant slowdown.

FUND PERFORMANCE

Performance

	Fund (%)	Benchmark* (%)	Relative (%)
Q3 2018	-0.43	-0.57	0.14
Rolling 12 months	1.26	-0.03	1.29
3 years p.a.	6.33	5.42	0.91
5 years p.a.	7.19	6.17	1.02
10 years p.a.	9.80	8.42	1.38
Since inception 02.07.2007	8.40	8.33	0.07



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]	99.4	98.9
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	0.4	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
Other	0.0	0.0

Fund data

	Fund	Benchmark[1]
Duration	10.0 years	10.2 years
Gross redemption yield[3]	3.41%	2.82%
No. of stocks	240	700
Fund size	£278.8m	-

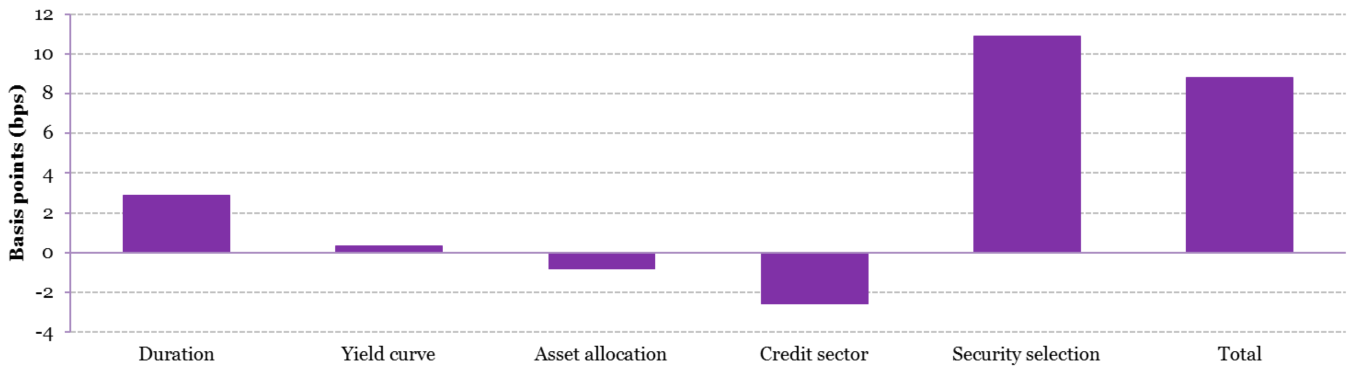
Source: RLAM, Launch date: 20.07.2007.

[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

Performance attribution for quarter 3 2018

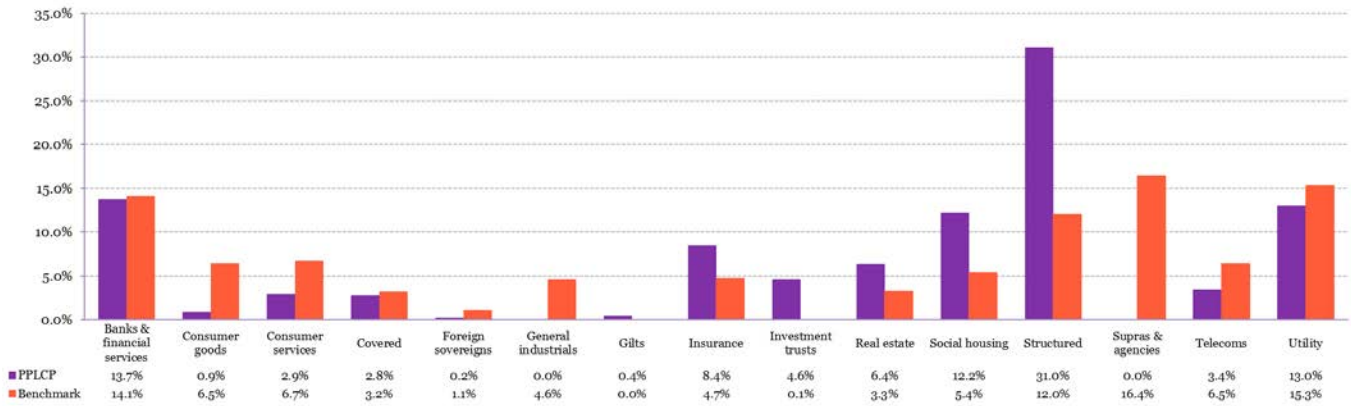


Source: RLAM and UBS Delta. The above performance attribution is an estimate. Please note that the attribution chart does not include residual effect returns.

ROYAL LONDON

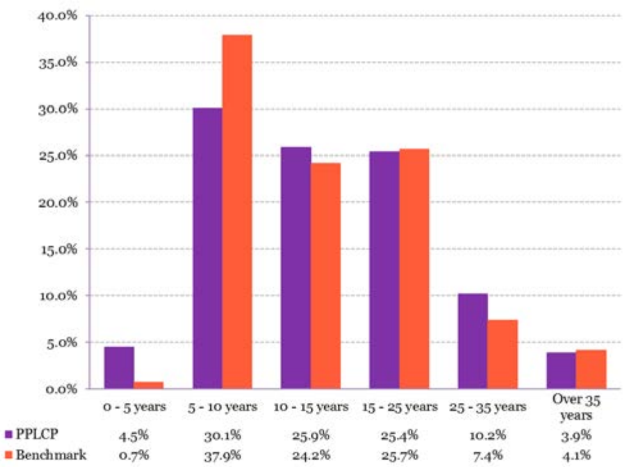
RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Sector breakdown

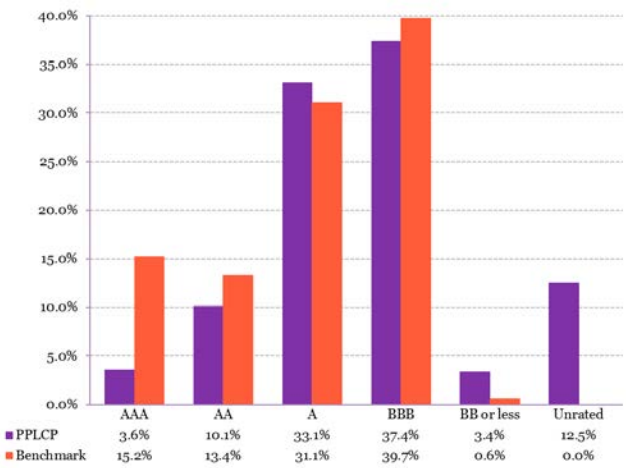


Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio

Maturity profile



Credit breakdown



Ten Largest Holdings

	Weighting (%)
HSBC Bank 5.375% 2033	1.5
Innogy Finance 6.125% 2039	1.4
Finance for Residential Social Housing 8.368% 2058	1.2
Barclays Plc 3.25% 2033	1.1
Lloyds Bank Plc 6% 2029	1.1
Aviva Plc 6.125% 2036	1.0
Prudential Plc 5.7% VRN 2063	1.0
SL Aberdeen 6.75% VRN Perpetual	1.0
Citigroup Inc 7.375% 02039	1.0
Equity Release 5.7% 2031	1.0
Total	**11.3**

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

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Portfolio review

	What we thought	What we did	What happened	Effect on portfolio
Sector	We expected corporate bonds to outperform supranational debt.	We kept the significant overweight position in corporate issues versus supranationals.	Supranational debt recorded its first quarterly underperformance of the wider sterling credit market in 2018, as revived investor appetite for risk supported demand for corporate bonds.	The fund's substantial underweight position in supranationals supported relative performance.
Sector	We continued to see value in financials (banks and insurers), and to favour subordinated debt over senior bonds.	The overweight exposure to subordinated financial debt and underweight holding of senior issues were broadly maintained.	Financial debt recorded a strong performance for the quarter as a whole, led by subordinated issues, as investors sought higher returns.	The overweight allocation to financial issues and the preference for subordinated debt were beneficial for performance.
Sector	We thought that high-profile, consumer-orientated and industrial bonds were unattractively priced, relative to other sectors.	We maintained the underweight allocation to consumer and industrial debt.	Consumer sectors mostly outperformed, led by media as bidding escalated in the high profile takeover battle for broadcaster Sky. Industrial issues lagged moderately behind the wider market.	The low weightings in consumer and industrial sectors did not have a material impact upon relative performance.
Sector	We continued to believe that secured bonds were undervalued relative to unsecured debt.	We kept the 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, underperformed over the quarter as a whole as investors focused on returns over security.	Above benchmark exposure to secured and structured debt was disadvantageous for returns, but this effect was offset by security selection.
Ratings	We believed lower rated credit bonds offered better value than AAA / AA rated securities. Credit ratings, while useful, are not a complete assessment of creditworthiness and value.	We maintained the bias towards lower rated bonds, and towards bonds rated below investment grade where we felt they were consistent with the fund's overall objective. Exposure to unrated bonds, which predominantly have investment grade risk characteristics and are in many instances secured, was broadly unchanged.	Lower rated debt outperformed AAA rated and AA rated bonds for the period as a whole, reflecting stronger investor appetite for risk. High yield bonds outperformed investment grade credit for the quarter as a whole. Unrated bonds in the fund, which consist mainly of secured and structured issues, generally outperformed.	The preference for lower rated debt supported relative performance during the quarter. The allocation to sub-investment grade debt supported returns. Exposure to unrated bonds had a small positive impact upon relative performance over the quarter.
Duration	We expected a gradual increase in UK government bond yields.	The fund's short duration stance versus the benchmark was maintained over the quarter.	Yields on benchmark 10-year gilts rose 30 basis points (bps) during the quarter, touching the highest level since February.	The short duration position had a positive impact upon relative performance.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Fund activity

- Sterling investment grade credit issuance rose sharply in the quarter from the prior three months, helped by a fourfold surge in September. Over 2018's first nine months, issuance declined modestly from the prior year.
- The fund increased its overweight exposure to financial debt by a small amount, maintaining the bias towards bank issues.
- Financial sectors continued to produce a plentiful supply of new debt, as the fund bought subordinated bonds of **HSBC**, **Pension Insurance Corp.** and **Prudential**, the latter a 50-year issue carrying a 6.25% coupon. Purchases also included senior issues from **Goldman Sachs**, **Banco Santander** and **CYBG**.
- Secured and structured sectors also remained a prominent area of new issue activity. In social housing, the fund bought long dated bonds of **Peabody**, which has origins dating to 1862, and **Blend Funding**, a new platform that on-lends the proceeds of debt sales to housing associations which typically lack the capacity or need to issue their own benchmark-size bonds. Purchases also included secured bonds of **Wales & West Utilities** and senior unsecured debt of real estate investment trust **Assura**, which manages a portfolio of primary care medical centres around the UK.
- In the secondary market, the fund increased allocations to structured debt of **Canary Wharf** and of **Progress Health**, reflecting the view that the bonds were attractively priced. Holdings of pub company **Enterprise Inns** and 100-year debt of the **University of Oxford** were expanded to invest cashflows. The fund sold exposures to social housing association **London & Quadrant Housing Trust** and utility **Veolia Environnement** to manage liquidity, and the sale of long dated debt of **Bromford Housing Group** reflected duration management. Within financials, bonds of **HSBC** were sold against **Goldman Sachs** debt to diversify risk.

Key views within the portfolio

- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration below 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.

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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Financial Statements

Portfolio Valuation

Trading Statement

Portfolio Valuation

As at 30 September 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									
85,101,458	GB00B1ZB3X88	RLPPC Over 5 Year Corp Bond Pen Fd	2.38765	107,593,762.46	203,192,497.32	0.00	203,192,497.32	0	100.0
			Funds Held total	**107,593,762.46**	**203,192,497.32**	**0.00**	**203,192,497.32**		**100.0**
			Grand total	**107,593,762.46**	**203,192,497.32**	**0.00**	**203,192,497.32**		**100.0**

Trading Statement

For period 01 July 2018 to 30 September 2018

Dorset County Pension Fund

	Trade Date	Transaction Type	Nominal	Security	Price (£)	Book Cost (£)
Acquisitions						
Funds Held						
	05 Jul 2018	Acquisition Rebate	62,997.69	RLPPC Over 5 Year Corp Bond Pen Fd	2.43	153,319.36
					Funds Held total	**153,319.36**
					Acquisitions total	**153,319.36**