ASSET MANAGEMENT

DORSET COUNTY PENSION FUND

Quarterly Report 31 December 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)
31 December 2018	**203.52**
30 September 2018	203.19
Change over the quarter	0.33
Net cash inflow (outflow)	0.00

Executive summary

Performance

- The Fund gave a gross return of 0.28% over the quarter, compared with a benchmark return of 0.16%.
- Sterling investment grade credit lagged behind UK government debt in the fourth quarter, the third quarterly underperformance of 2018; respective all-maturities returns were 0.14% and 1.92%. Widening credit spreads, volatile equities markets and slumping oil prices spurred investor demand for the security of government bonds and curbed buying of corporate debt. The average sterling investment grade spread widened by 31 basis points (bps) to 1.51% by the end of the period. The Fed raised its key interest rate for a fourth time in 2018, and the ECB confirmed the end of its monetary stimulus after December.
- The Fund outperformed the broader sterling credit market, with positive effects from our structured exposure offset by our overweight in financials and underweight in supranationals.

The economy & bond markets

- Global growth has slowed more than expected in recent months; the composite Purchasing Managers' Indices indicator continues to signal expansion, but is below levels seen earlier in 2018. Export orders have led the fall in business surveys this year, following a sizable pick-up in trade in 2017, and the strong dollar, high oil prices (for most of the year) and rising interest rates have proved a challenging backdrop for some economies. Worries related to Brexit, Italy and global trade tensions have kept firms more cautious than they would otherwise be. Some countries have faced one-off issues that curbed activity, e.g. the UK (bad weather) in the first quarter and Germany (disruptions related to the automotive industry) in the third quarter.
- While Brexit has dominated headlines in the UK during 2018, economic growth is likely, ultimately, to have averaged below pre-crisis norms. This reflects factors including a lack of spare capacity (limiting the room for non-inflationary further growth), still weak real income growth, and a drag on investment and exports reflecting uncertainty around Brexit and global growth.
- The fourth quarter was generally positive for government bonds. A backdrop of soft, albeit still positive economic data, a collapsing oil price and trade tensions led to a general 'risk off' environment. Most government bond markets subsequently enjoyed strong returns – particularly in December. Credit markets underperformed, with investment grade spreads wider in the major markets of the US, Europe and UK.

PORTFOLIO REVIEW

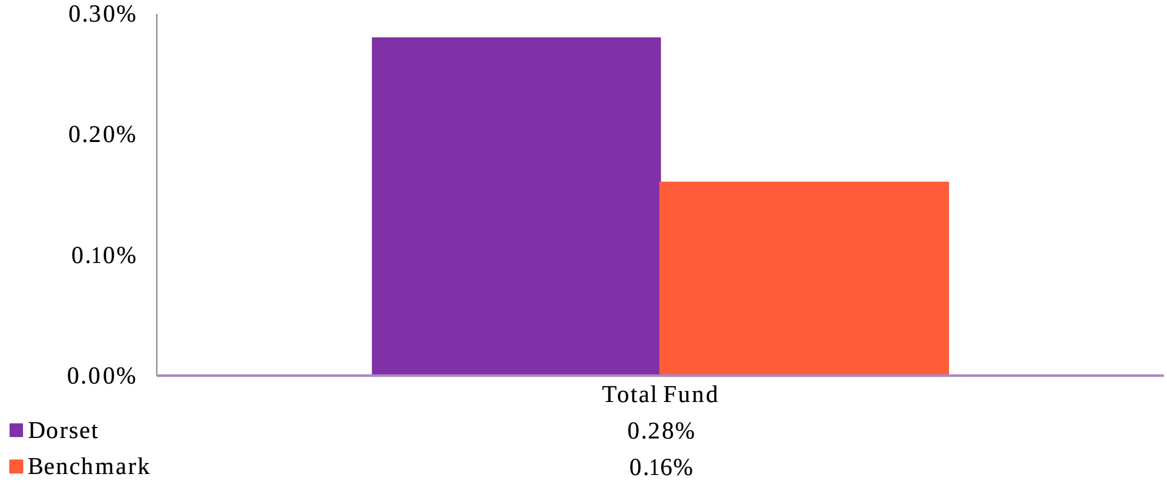
Investment outlook

- We are cautious on the global economic outlook, rather than pessimistic - we are not forecasting a 2019 recession. World growth has lost more momentum than expected, US interest rates have been hiked further, financial conditions have tightened and trade tensions could easily revive. However, US fiscal policy remains supportive for now, China has eased policy and the oil price has dropped. Our central case remains relatively benign, but we expect growth to bump lower in 2019 as business cycles mature and policy support fades.
- We have lowered our growth forecasts slightly and now expect global growth closer to 3.4% by the end of next year (previously forecasting it towards the bottom of a 3.5%-4.0% range), reflecting the fact that momentum has slowed more than expected in 2018's second half.
- We expect the Fed to keep raising rates at a gradual pace, stopping near a neutral level after two more 25bp hikes. We anticipate a BoE rate increase in May 2019, assuming a Brexit withdrawal deal is reached, with subsequent rises once every three quarters. December is the final month of the ECB's monetary stimulus; we expect rates to rise very gradually, with the first hike late in 2019's third quarter. We anticipate further easing by China's central bank as the economy shows more signs of slowing. In Japan, meaningful policy tightening still seems a long way off.

FUND PERFORMANCE

Performance

	Fund (%)	Benchmark* (%)	Relative (%)
Q4 2018	0.28	0.16	0.12
Year-to-date	-1.52	-2.23	0.71
Rolling 12 months	-1.52	-2.23	0.71
3 years p.a.	6.34	5.38	0.96
5 years p.a.	7.13	6.26	0.87
Since inception p.a. 02.07.2007	7.56	6.22	1.34



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]	99.7	98.9
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	0.3	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	9.8 years	10.0 years
Gross redemption yield[3]	3.63%	3.00%
No. of stocks	186	717
Fund size	£204.8m	-

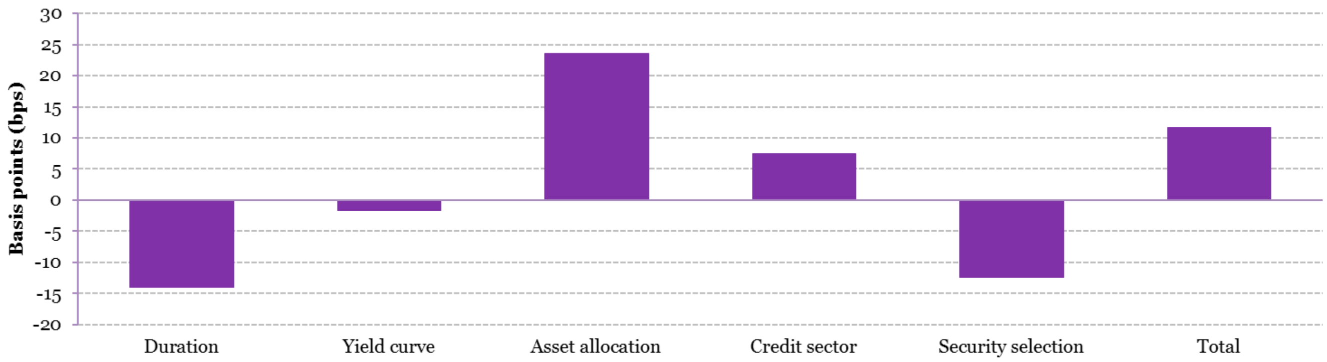
Source: RLAM, Launch date: 20.07.2007.

[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

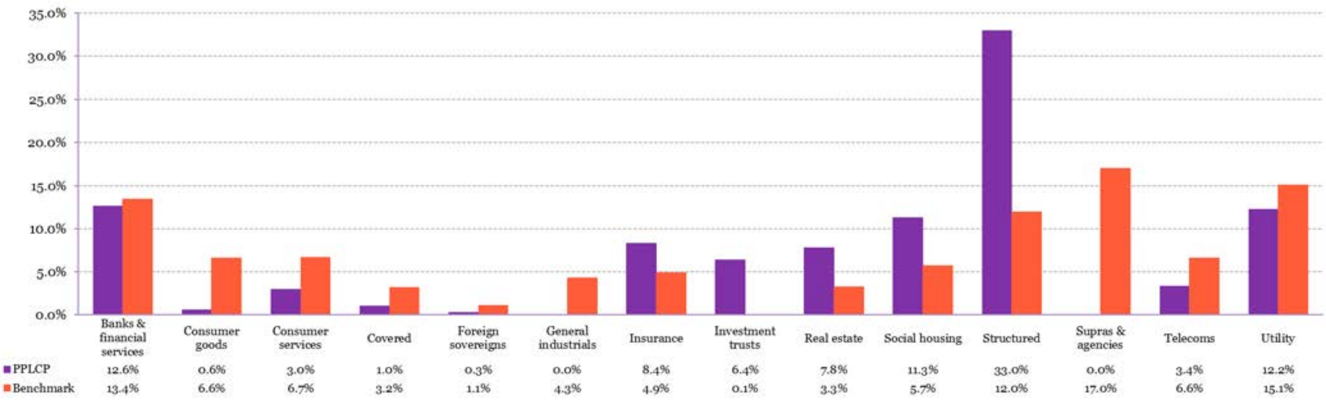
Performance attribution for quarter 4 2018



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

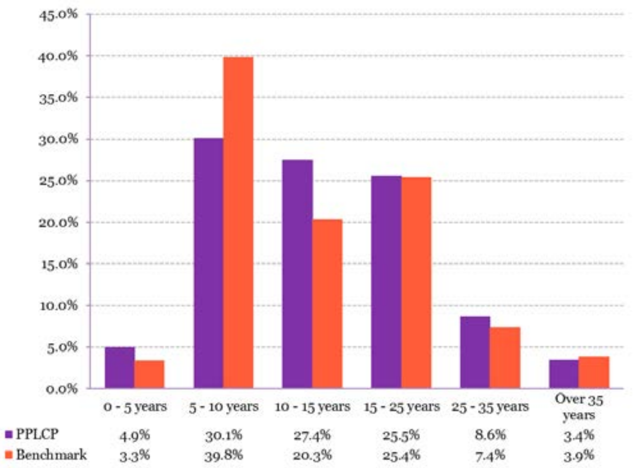
RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Sector breakdown

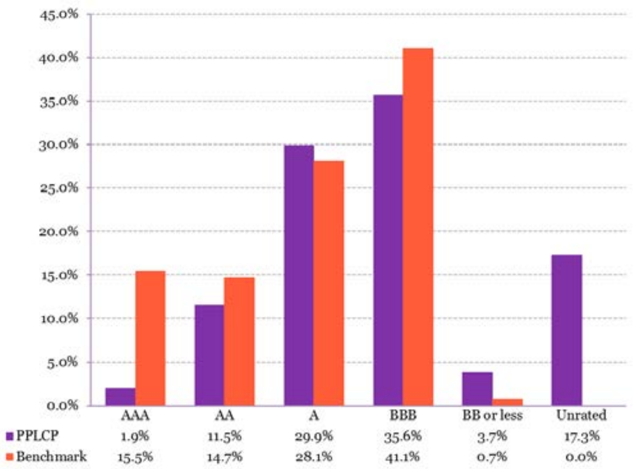


Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio

Maturity profile



Credit breakdown



Ten Largest Holdings

	Weighting (%)
HSBC Bank 5.375% 2033	2.0
Finance for Residential Social Housing 8.368% 2058	1.5
Exchequer Partnership 5.396% 2036	1.3
Equity Release 5.7% 2031	1.3
Prudential Plc 5.7% VRN 2063	1.3
Innogy Finance 6.125% 2039	1.3
Annes Gate Property 5.661% 2031	1.3
Thames Water Utilities 2 7.738% 2058	1.2
Électricité De France 6% 2114	1.2
Barclays Plc 3.25% 2033	1.1
Total	**13.5**

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 underweight position in supranationals versus corporate issues.	Supranational debt, one of 2017's weakest sectors, outperformed the wider sterling credit market for a third quarter in 2018, as credit spreads widened and investors avoided risk. Supranationals outperformed for 2018 as a whole.	The fund's substantial underweight position in supranationals was disadvantageous for relative performance.
Sector	We continued to see value in financials (banks and insurers), and to favour subordinated debt over senior bonds.	The fund retained its overweight exposure to subordinated financial debt and reduced the allocation to senior issues, moving the latter position further below benchmark.	Within financials, senior issues outperformed as subordinated bonds lagged behind. This reflected investor risk aversion and weakness in the subordinated debt of General Electric, a significant component of credit indices.	The above benchmark position in subordinated financial debt and underweight holding of senior issues detracted from returns. In the case of GE, this effect was increased by the overall above benchmark exposure to the company.
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.	Within secured and structured sectors, which typically comprise longer dated bonds and span a wide range of industries, ABS outperformed and real estate was in line with the broad market.	Above benchmark exposure to secured and structured debt was broadly positive for relative performance. Security selection had an additional strong positive impact.
Ratings	We believed lower rated credit bonds offered better value than AAA and AA rated securities. Credit ratings, while useful, are not a complete assessment of creditworthiness and value.	We maintained the bias towards lower rated debt, 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 expanded.	Lower rated debt lagged behind AAA and AA rated bonds, as investors shied away from risk. High yield bonds markedly underperformed 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 detracted from relative performance during the quarter. The allocation to sub-investment grade debt had a negative impact on returns. Exposure to unrated bonds had a small positive impact upon relative performance over the quarter, helped by the increase in the size of the holding.
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 fell by 30 basis points (bps), declining throughout the period and reversing the third quarter's rise.	The short duration position had a negative impact upon relative performance.

RLPPC UK OVER 5 YEAR CORPORATE BOND FUND

Fund activity

- Sterling investment grade credit issuance was very subdued during the quarter, amounting to less than half of the year-earlier level. For all of 2018, sterling credit issuance fell by about a quarter from the prior year.
- A small allocation to UK government debt was used to manage cash. The fund had no exposure to gilts at the end of the quarter.
- By credit sector, the largest changes over the quarter were reductions in exposures to banks and covered bonds.
- Secured and structured sectors continued to be significant sources of new issue activity. The fund took part in **Income Contingent Student Loans**, the government's second securitisation of student loan debt, buying bonds from the A2 (fixed rate) tranche. Purchases also included long-dated secured debt of **Southern Housing Group**, as social housing associations continued to tap the credit market for financing, and a 'green' structured issue from utility **Anglian Water**.
- While financial companies were less active than in earlier quarters of 2018, the fund participated in an issue of new long-dated subordinated debt by insurer **Legal & General**. In other sectors, purchases encompassed senior unsecured bonds of German auto manufacturer **Volkswagen**, which raised £800 million and €4.25 billion across six tranches, and real estate investment trust **Digital Realty Trust**, which operates data centres around the world.
- In the secondary market, selling took place across a wide variety of holdings in order to maintain the shape of the fund while managing liquidity to cover the outflow referenced previously. Sales included financials **Barclays**, **Citigroup** and **Aviva**; utilities **Severn Trent**, **Cadent** and **Innogy**; social housing organisations **Places for People** and **Housing Finance Corp.**; and covered bonds of **Commonwealth Bank of Australia** and **Lloyds Bank**. Exposure to **General Electric** was increased. In switching trades, the fund achieved higher yields by moving between issues of financials **Standard Chartered** and **Clydesdale Bank**.
- Financial **Standard Life Aberdeen** repurchased subordinated debt above prevailing market levels.

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 2019.
- 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 31 December 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										
	85,166,628	GB00B1ZB3X88	RLPPC Over 5 Year Corp Bond Pen Fd	2.38971	107,749,621.05	203,523,542.40	0.00	203,523,542.40	0	100.0
				Funds Held total	**107,749,621.05**	**203,523,542.40**	**0.00**	**203,523,542.40**		**100.0**
				Grand total	**107,749,621.05**	**203,523,542.40**	**0.00**	**203,523,542.40**		**100.0**

Trading Statement

For period 01 October 2018 to 31 December 2018

Dorset County Pension Fund

	Trade Date	Transaction Type	Nominal	Security	Price (£)	Book Cost (£)
Acquisitions						
Funds Held						
	04 Oct 2018	Acquisition Rebate	65,169.44	RLPPC Over 5 Year Corp Bond Pen Fd	2.39	155,858.59
					Funds Held total	**155,858.59**
					Acquisitions total	**155,858.59**