ASSET MANAGEMENT

DORSET COUNTY PENSION FUND

Quarterly Report 31 December 2019

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CONTENTS

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 2019	229.35
30 September 2019	230.37
Change over the quarter	(1.02)
Net cash inflow (outflow)	0.00

Executive summary

Performance

- The Fund gave a gross return of -0.45% over the quarter, bringing the 12 month return to 12.69%.
- Sterling investment grade credit outperformed UK government debt in the fourth quarter; respective all-maturities returns were -0.69% and -3.89%. The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) narrowed by 15bps to 1.14% by the end of the period.
- The fund outperformed the sterling credit market, with positive effects from our underweight in supranationals and overweight in financials – particularly subordinated bonds – driving returns.

The economy and bond markets

- There were signs of stabilisation in global economic growth in the fourth quarter, with GDP growth rates consistent and the composite PMI healthy. Nevertheless, the global economy undoubtedly slowed and leading indicators were mixed. Business optimism improved somewhat, aided by developments around global trade and Brexit, and developed economy consumer confidence held up well. Accommodative central bank policies mean that financial conditions are looser than normal, and there were numerous announcements towards the end of the year suggesting a pick-up in government spending.
- The UK GDP growth rate continued its descent in the fourth quarter, hampered by uncertainty around Brexit and the subdued global backdrop. A resounding Conservative Party majority in the general election removed the threat of a 'no deal' Brexit as a near-term possibility and provided greater clarity over the domestic political outlook. However, Prime Minister Boris Johnson's declaration that the transition period will end in December 2020 means that significant economic risks remain. The Conservative manifesto outlined plans for a significant boost to government spending, which should boost growth prospects.
- Sentiment shifted in government bond markets in the fourth quarter. Having reached unprecedented levels in the previous quarter, government bonds sold off strongly as many of the fears that had been driving risk-off sentiment subsided. The US and China agreed to a 'phase one' trade deal, and concerns lessened about the weakness of the global economy in light of more supportive central bank policies and several governments announcing a ramp-up in spending. Political risk was also reduced somewhat after the UK Conservative Party secured a substantial majority in the general election, enabling the country's withdrawal from the EU.

Investment outlook

- Despite a prospective surge in UK government spending, growth is likely to be kept in check by uncertainty around the future relationship with the EU. There is still potential for a disruptive change to the UK's trading arrangements with the EU in the coming year, and the government's preferred future EU trading arrangement implies substantial adjustment from current arrangements; which will come at a cost for some businesses. With global growth having slowed, other central banks having cut rates, domestically-driven inflation subdued and UK business surveys weak, we have pencilled in a rate cut for the first half of 2020, though this could change if business surveys were to pick up significantly in the next couple of months.
- We expect investment grade credit will outperform gilts in 2020, in part reflecting the lower duration of credit indices relative to gilt indices. We do not expect further credit spread tightening in the current year, although it is possible that renewed optimism about global growth could push spreads towards the low seen in 2016 of 0.93%.

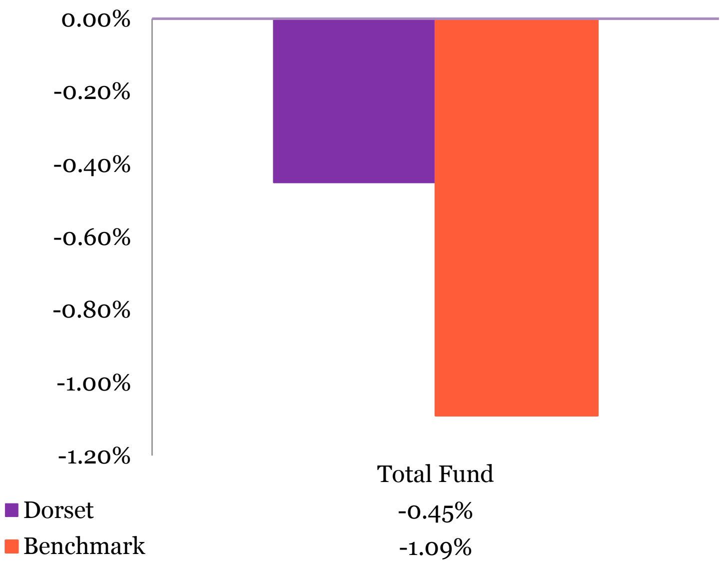
FUND PERFORMANCE

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Q4 2019	**-0.45**	**-1.09**	**0.64**
Year-to-date	12.69	12.15	0.54
Rolling 12 months	12.69	12.15	0.54
3 years p.a.	6.17	4.97	1.20
5 years p.a.	6.40	5.61	0.79
Since inception p.a. 02.07.2007[2]	8.57	8.47	0.10

All performance figures stated gross of fees and tax unless otherwise stated.

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



RLPPC OVER 5 YEAR CORPORATE BOND FUND

Asset split

	Fund (%)	Benchmark[1] (%)
Conventional credit bonds[2]	99.7	99.0
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	1.0
Foreign index linked sovereign	0.0	0.0
Derivatives	0.0	0.0
Other	0.0	0.0

Fund data

	Fund	Benchmark[1]
Duration[3]	10.0 years	10.4 years
Gross redemption yield[4]	2.83%	2.16%
No. of stocks	442	748
Fund size	£229.4m	-

Source: RLAM, 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]Excluding cash

[4]The gross redemption yield is calculated on a weighted average basis

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Past performance is not necessarily a reliable indicator of 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.

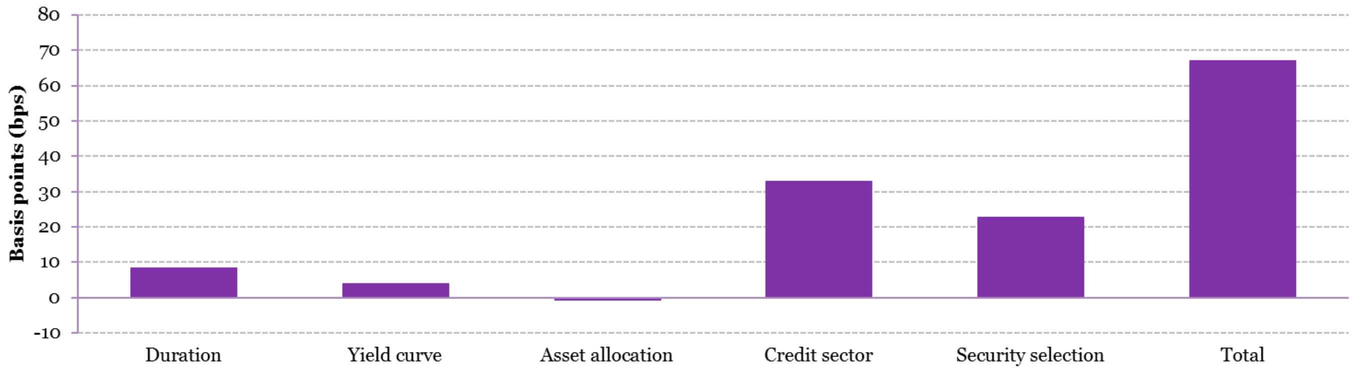
All performance figures stated gross of fees and tax unless otherwise stated.

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

[2] The fund launched 02.07.2007 but its benchmark and objective changed on 30.06.2012.Performance prior to 30.06.2012 has therefore been omitted. If you require performance prior to this change, please contact your client account manager.

The fund objective is to outperform the benchmark by 0.80% per annum gross of the standard management fees.

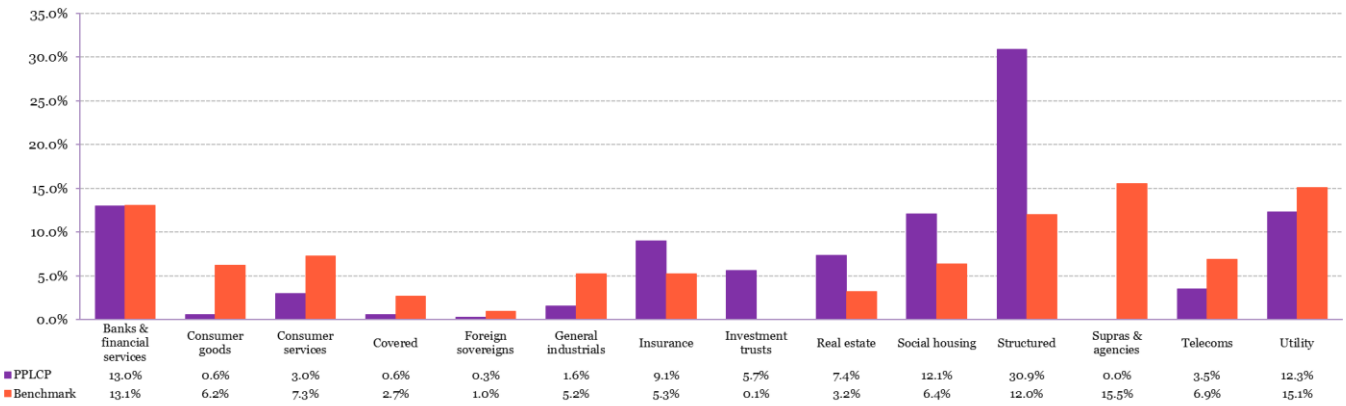
Performance attribution for quarter 4 2019



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

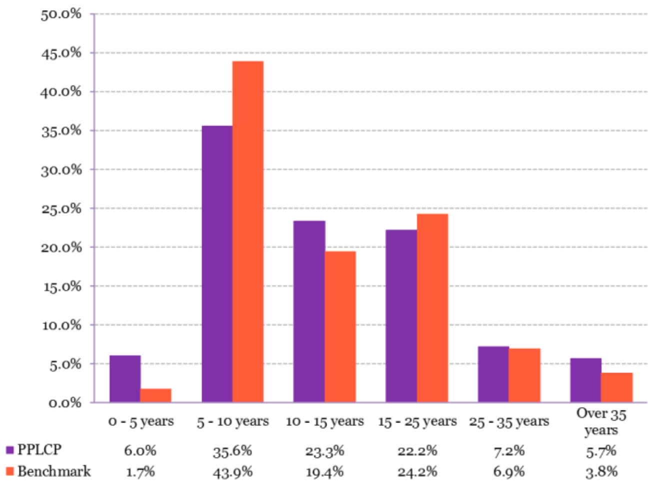
RLPPC OVER 5 YEAR CORPORATE BOND FUND

Sector breakdown

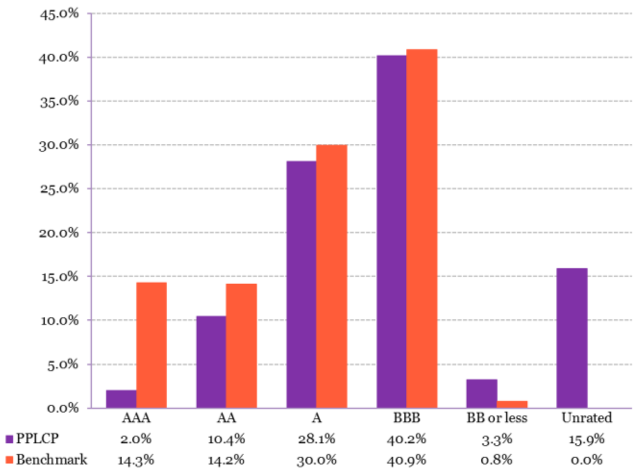


Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio

Maturity profile



Credit breakdown



Ten Largest Holdings

	Weighting (%)
HSBC Bank 5.375% 2033	2.0
Électricité De France 6% 2114	1.3
M&G Plc 5.7% 2063	1.3
Finance for Residential Social Housing 8.368% 2058	1.3
Innogy Finance 6.125% 2039	1.3
Exchequer Partnership 5.396% 2036	1.2
Thames Water Utilities 2 7.738% 2058	1.2
Annes Gate Property 5.661% 2031	1.2
Barclays Plc 3.25% 2033	1.2
Equity Release 5.7% 2031	1.1
Total	**13.0**

Source: RLAM. Figures in the table above exclude derivatives where held, subject to rounding.

RLPPC 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 was the worst-performing credit sector.	The fund's substantial underweight position in supranationals had a strong positive impact on performance this quarter.
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 the below benchmark holding of senior issues were broadly maintained.	Banks and insurers both outperformed the broader market. Within these sectors, senior bonds largely underperformed subordinated issues.	The overweight position in financials was very positive for performance. This was further enhanced by the preference for subordinated debt.
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 and real estate both underperformed.	Above benchmark exposure to structured debt was broadly negative for performance.
Ratings	We believed lower-rated credit bonds offered better value than AAA and AA rated securities.	The bias towards lower-rated debt was maintained over the quarter.	AAA and AA rated bonds underperformed their lower-rated peers, particularly BBB.	The preference for lower-rated debt had a positive impact on performance this quarter.
Ratings	Credit ratings, while useful, are not a complete assessment of value and creditworthiness.	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 issues, which predominantly have investment grade risk characteristics and are in many instances secured, was broadly unchanged.	High yield debt strongly outperformed investment grade credit over the quarter. Unrated bonds in the fund, which consist mainly of secured and structured issues, underperformed.	The allocation to sub-investment grade debt was positive for returns. Exposure to unrated bonds marginally detracted from performance.
Duration	We believe the level of gilt yields is challenging over the longer term. However, our level of conviction is low regarding their short-term direction.	The fund broadly maintained its slight short duration stance versus the benchmark over the quarter.	The yield on the 10-year gilt increased by 33 basis points to 0.82%, reversing the year's general decrease in yields.	The duration position had a small positive impact on performance.

RLPPC OVER 5 YEAR CORPORATE BOND FUND

Fund activity

- Sterling investment grade credit issuance for the quarter was lower than the third quarter, but higher than in the weak markets of the fourth quarter of 2018. The fund participated in various new issues, including in the utilities sector from **Cadent**, **Eastern Power Networks** and a bond issued by Berkshire Hathaway subsidiary **Northern Powergrid**. We maintained our interest in the social housing sector, through **Wrekin Housing Group**. Otherwise, we participated in a new issue from **National Express**; and structured issues from **Logicor**, the warehouse and logistics company, and **Heathrow Finance**, the holding company issuer for Heathrow Airport.
- With the Conservatives securing a clear parliamentary majority, investors concluded that greater political clarity will lead to more economic stability. Sterling strengthened on the result and UK risk assets rallied sharply. While there was little impact on gilt yields, in credit the financials and utilities sectors outperformed. The threat of nationalisation of certain utilities impacted the performance of bonds earlier in the quarter in the run up to the election. The result led to a bounce, with spreads contracting across the utilities sector. While the fund benefitted from this recovery, there remain challenges ahead (e.g. tougher regulation) and we retain our preference for debt issued by operating entities.
- During the quarter, French utility **EDF** launched a tender for some of its outstanding euro-denominated hybrid debt (subordinated bonds), thereby reducing the overall amount of its outstanding hybrid capital. This tender process supported the performance of the company's remaining hybrids bonds; sterling EDF hybrids that are callable in 2029 returned in excess of 20% over the year. As the fourth-largest issuer in the sterling credit market, making up over 2% of all maturity indices, the performance of EDF's debt has a meaningful market impact.
- In December, **Phoenix** (the largest consolidator of life assurance funds in the UK) agreed to acquire **ReAssure Group** for a combination of cash and shares. Fitch revised the outlook on both issuers to positive, citing the advantages of increased size and business position for Phoenix and the expectation that ReAssure would ultimately be integrated within the enlarged group. Over the quarter, the fund benefitted from its overweight position in the insurance sector and, in particular, from its positions in Phoenix and ReAssure.

Investment outlook

- Before Christmas, the new government introduced the EU Withdrawal Agreement Bill and the UK is set to leave the EU on 31 January. However, negotiations over a future trade agreement talks are set to continue until the end of this year, so uncertainty could continue to affect economic activity. Our sterling credit portfolios have a low relative exposure to those sectors most exposed to trading interaction between the UK and the EU (e.g. general industrials and consumer goods). Such uncertainty reinforces our favoured approach of ensuring significant diversification of issuers and biasing our portfolio towards bonds with strong asset backing and/or covenant protections to mitigate such risks.
- Over 2019, the performance of sterling investment grade credit was boosted by the strength in UK government bonds (the benchmark 10-year gilt yield decreased from 1.28% to 0.82%) and credit spread compression as higher-risk assets outperformed. The average sterling investment grade credit spread tightened 37 basis points to 1.14%, with around two-thirds of this coming from financials. However, the fourth quarter saw a significant *increase* in government bond yields from their low of 0.41% in September and it's possible that yields will rise further in 2020.
- We expect investment grade credit will outperform gilts in 2020, in part reflecting the lower duration of credit indices relative to gilt indices. We do not expect further credit spread tightening in the current year, although it is possible that renewed optimism about global growth could push spreads towards the low seen in 2016 of 0.93%.

Key views within the portfolio

- A significant underweight in supranational bonds, as we expect corporate debt to outperform over the medium term.
- Duration moderately below that of the benchmark, as we expect underlying gilt yields to gradually trend higher.
- A bias towards asset-backed securities, an area that we believe still offers very strong 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.

Stewardship and Responsible Investment at RLAM

Please click on link for further information.

Royal London Fixed Income ESG Analysis

Please click on link for further information.

Royal London Equities Voting and Engagement

Please click on link for further information.

Glossary

Please click on link for a glossary on terms.

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Portfolio Valuation

As at 31 December 2019

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										
	85,416,355	GB00B1ZB3X88	RLPPC Over 5 Year Corp Bond Pen Fd	2.68503	108,394,530.36	229,345,476.57	0.00	229,345,476.57	0	100.0
				Funds Held total	**108,394,530.36**	**229,345,476.57**	**0.00**	**229,345,476.57**		**100.0**
				Grand total	**108,394,530.36**	**229,345,476.57**	**0.00**	**229,345,476.57**		**100.0**

Trading Statement

For period 01 October 2019 to 31 December 2019

Dorset County Pension Fund

Acquisitions

Funds Held

Trade Date	Transaction Type	Nominal	Security	Price (£)	Book Cost (£)
04 Oct 2019	Acquisition Rebate	63,164.91	RLPPC Over 5 Year Corp Bond Pen Fd	2.73	172,643.60
				Funds Held total	**172,643.60**
				Acquisitions total	**172,643.60**