ROYAL LONDON

ASSET MANAGEMENT

DORSET COUNTY PENSION FUND

Quarterly Report 31 March 2019

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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 March 2019	**214.35**
31 December 2018	203.52
Change over the quarter	10.83
Net cash inflow (outflow)	0.00

Executive summary

Performance

- The Fund gave a gross return of 5.32% over the quarter, bringing the 12 month return to 4.82%.
- Sterling investment grade credit spreads tightened during the quarter as a whole. Risk assets rebounded after a weak fourth quarter of 2018, while receding fears over interest rate increases helped push fixed income yields lower. The average credit spread (the yield premium of credit bonds over UK government bonds) tightened over the quarter as a whole by 19 basis points (bps), ending March at 132bps. Spreads were tighter across all sectors of the sterling credit market. In sector terms, increased investor risk appetite meant that sectors perceived as riskier outperformed.
- The Fund slightly underperformed the sterling credit market, with negative effects from our structured exposure offsetting the positive from our overweight in financials and underweight in supranationals.

The economy and bond markets

- Global growth likely continued to slow in the first quarter, with several major economies looking close to stagnation. Trade indicators remained weak throughout the period, likely reflecting a slowdown in the Chinese economy, tariff fears and political uncertainty. On the other hand several risks faded, with progress in trade talks between the US and China, more dovish central banks, looser financial conditions and broadly rising pay growth. While oil prices have risen, they remained below levels seen over much of 2018, and so headline inflation has fallen, providing a real terms boost to disposable incomes.
- Data broadly pointed to some slowing in the outperforming US economy, with several recessionary indicators flashing 'amber', such that the Federal Reserve (Fed) no longer expects that it will raise interest rates in 2019. The government shutdown and uncertainty around global trade both weighed on business sentiment. Inflation, both headline and core, weakened over the period, while growth in average hourly wages remained at similar levels to the previous quarter.
- The UK economy appears to have slowed, though the ongoing lack of Brexit resolution is having distortive effects on surveys and hard data. Fiscal policy became more accommodative, with the Spring Statement resulting in a small net stimulus, and the Bank of England (BoE) indicated a more dovish interest rate stance.
- Sterling investment grade credit outperformed UK government debt in the first quarter; respective all-maturities returns were 4.06% and 3.38%. Credit spreads narrowed as dovish shifts from central banks contributed to the relative attractiveness of corporate debt over the security of government bonds. The average sterling investment grade credit spread narrowed by 19 bps to 1.32% by the end of the period.

PORTFOLIO REVIEW

Investment outlook

- Global GDP growth looks set to slow in 2019, but with more weakness in the first half of 2019 than we had expected. The outlook for the second half of 2019 appears brighter, given responses from policy makers and improvements in financial conditions, though trade relations and Brexit continue to pose threats. A reduced likelihood of further US-China tariff hikes, a continuation of stimulus from China and a pause in central bank interest rate hikes should all support growth in the year.
- We have lowered our growth forecasts and expect 2019 global GDP growth to be 3.3%, compared to 3.5% previously. That largely reflects a weaker than expected end to 2018 and a weaker than expected start to 2019. Our forecasts for 2020 are little changed and higher in some cases, partly reflecting that we no longer assume US-China tariffs rise from current levels and now assume that monetary policy will be tightened by less than previously expected.
- We expect the Fed to refrain from further rate rises for most of 2019. We anticipate a BoE rate increase in the second half of the year, assuming a withdrawal deal of some form is agreed, with subsequent rate hikes once every three to four quarters. We do not expect any rate rises from the ECB until early 2020, and think it will then hike very gradually. We expect further easing from the People's Bank of China, though cautiously. In Japan, meaningful policy tightening still seems a long way off.

FUND PERFORMANCE

Performance

	Fund (%)	Benchmark[1] (%)	Relative (%)
Q1 2019	**5.32**	**5.36**	**-0.04**
Year-to-date	5.32	5.36	-0.04
Rolling 12 months	4.82	4.49	0.33
3 years p.a.	7.02	5.86	1.16
5 years p.a.	7.41	6.75	0.66
Since inception p.a. 02.07.2007[2]	8.52	8.46	0.06

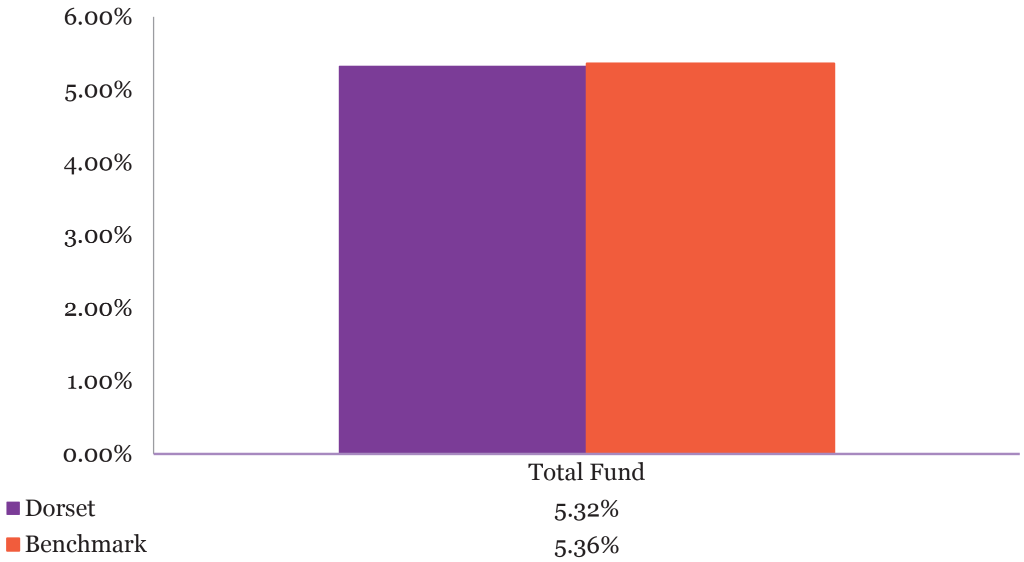
Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

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.



Source: RLAM, gross of standard management fees.

**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	10.0 years	10.4 years
Gross redemption yield[3]	3.27%	2.49%
No. of stocks	197	693
Fund size	£215.7m	-

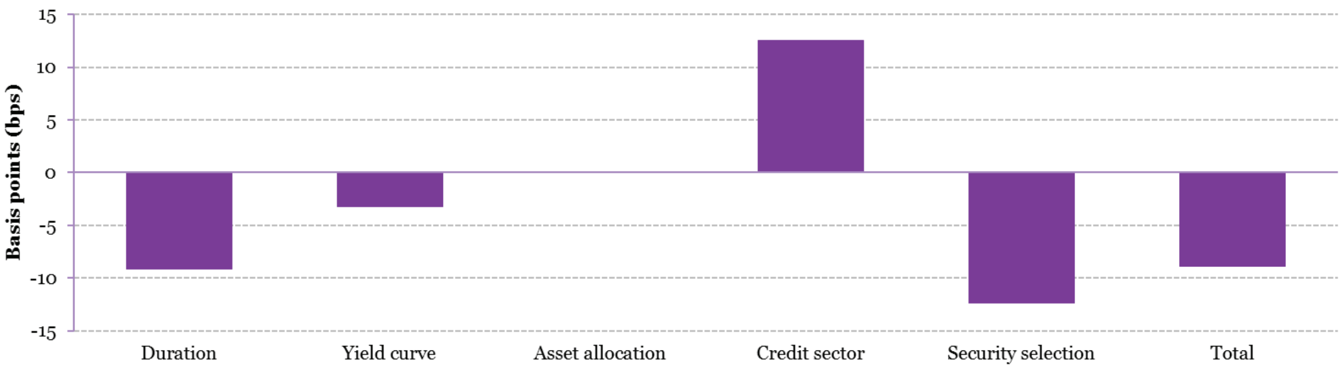
Source: RLAM, Launch date: 20.07.2007.

[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

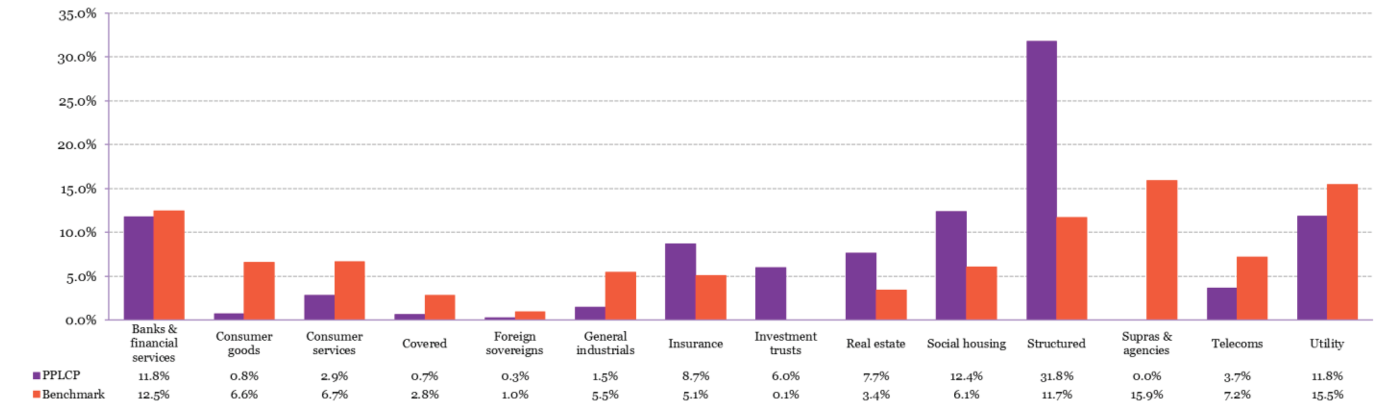
Performance attribution for quarter 1 2019



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

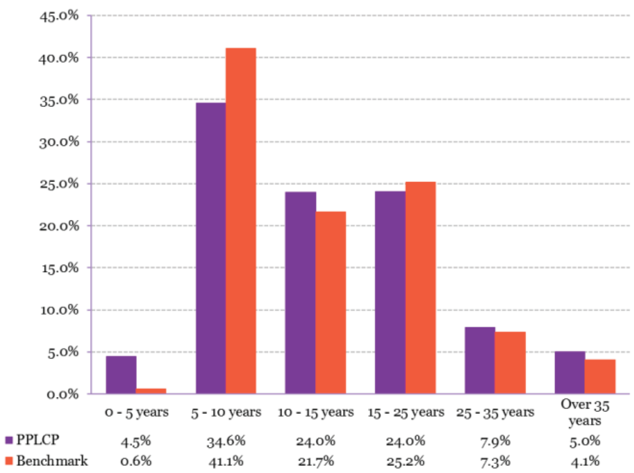
RLPPC OVER 5 YEAR CORPORATE BOND FUND

Sector breakdown

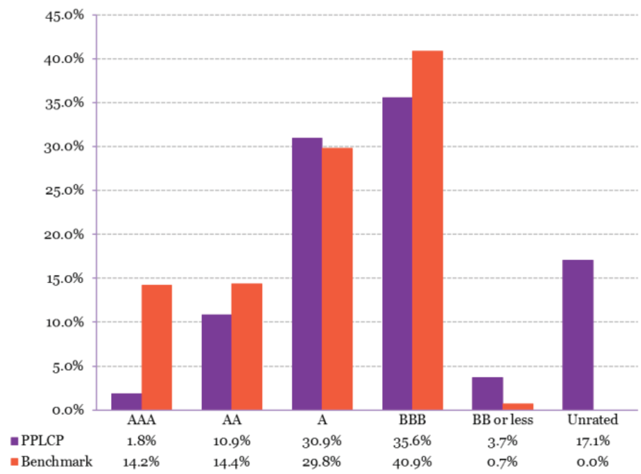


Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio

Maturity profile



Credit breakdown



Ten Largest Holdings

	Weighting (%)
HSBC Bank 5.375% 2033	2.1
Finance for Residential Social Housing 8.368% 2058	1.5
Prudential Plc 5.7% VRN 2063	1.4
Innogy Finance 6.125% 2039	1.3
Électricité De France 6% 2114	1.3
Exchequer Partnership 5.396% 2036	1.3
Equity Release 5.7% 2031	1.2
Thames Water Utilities 2 7.738% 2058	1.2
Annes Gate Property 5.661% 2031	1.2
Barclays Plc 3.25% 2033	1.1
Total	**13.5**

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, which outperformed for 2018 as a whole, underperformed as investors adopted a more 'risk on' approach.	The fund's substantial underweight position in supranationals was a key driver of relative 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.	Financials outperformed the broader market. Subordinated bonds broadly outperformed as senior issues lagged behind. This reflected increased investor risk appetite.	The above benchmark position in subordinated financial debt and underweight holding of senior issues contributed positively to 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 gave mixed returns. Media and telecoms outperformed, consumer goods was among the weakest sectors. Industrial issues broadly outperformed and capital goods was the best-performing subsector.	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.	Within secured and structured sectors, which typically comprise longer dated bonds and span a wide range of industries, ABS underperformed the market.	Above benchmark exposure to structured debt was negative.
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.	Lower rated debt outperformed AAA and AA rated bonds, as investors embraced higher risk.	The preference for lower rated debt contributed strongly to relative performance.
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 marginally outperformed investment grade credit for the quarter as a whole. Unrated bonds in the fund, which consist mainly of secured and structured issues, marginally outperformed.	The allocation to sub-investment grade debt was positive for returns. Exposure to unrated bonds had a small positive impact on relative performance over the quarter.
Duration	We expected a gradual increase in UK government bond yields.	The fund broadly maintained its moderate short duration stance versus the benchmark over the quarter.	Yields on benchmark 10-year gilts fell by 27 basis points, continuing last quarter's fall.	The duration position had a negative impact on relative performance.

RLPPC OVER 5 YEAR CORPORATE BOND FUND

Fund activity

- Following very subdued levels in the fourth quarter of 2018, sterling investment grade credit issuance picked up in the first quarter of 2019 to a level moderately above that of the first quarter of 2018.
- By sector, the fund reduced its position in structured debt and increased the holding of utilities, social housing, consumer goods and general industrials. This increased the overweight in social housing, and reduced the overweight in structured and the underweights in utilities, consumer goods and general industrials.
- In new issue activity, the fund continued to implement its strategic view of adding to social housing, with purchases of long-dated debt of **MORhomes, Hastoe Capital**, **Futures Housing Group, Clarion Housing Group** and **Incommunities**. In the financial sector, purchases included **Clydesdale Bank**, **BNP Paribas** and **HSBC**. Other notable purchases included a 12-year bond of Australian natural gas provider **APT Pipelines**. We also bought new issues from utility company **Severn Trent**, pub and hotel company and brewer **Greene King**, Anglo-Swiss mining and commodity trading company **Glencore**, and electricity generator/transmitter **London Power Networks**.
- Away from new issues, the fund bought bonds of **BNP Paribas** and **British American Tobacco**, and added to its holdings in **Legal & General**, **HSBC** and US property company **Digital Stout**. It switched holdings in **RBS** to pick up yield and from **Credit Suisse** to more attractive bonds in **BNP Paribas**. Sales included **Bank of Scotland**, **Co-operative Bank** and **Vattenfall**, the Swedish state-owned power company.

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, particularly if Brexit-related uncertainty is ended with a deal between the UK and EU.
- 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.

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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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