AllenbridgeEpic
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REPORT PREPARED FOR

Oxfordshire Council Pension Fund

Q3 2013

11 November 2013

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OXFORDSHIRE PENSION FUND COMMITTEE - 6 DECEMBER 2013

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. The UK economy grew by 0.8% in the third quarter, with all areas of the economy contributing. Together with positive industry surveys, this has caused an increase in forecasts for growth in 2013 and 2014, as highlighted in the table below. Second-quarter growth in the Eurozone turned positive for the first time in six quarters, but the very low inflation figure prompted the ECB to lower interest rates by 0.25% in November, to avert the threat of deflation. The Japanese and Chinese economies have maintained their growth levels, although there have been slight reductions in the outlook for the United States.

(In the table below, bracketed figures show the forecasts at the time of the September Committee)

Consensus real growth (%)						**Consumer prices latest (%)**
	2010	**2011**	**2012**	**2013E**	**2014E**	
UK	+1.6	+0.9	-0.1	**(+1.0) +1.4**	+2.3	+2.7 (CPI)
USA	+2.9	+1.7	+2.2	(+1.7) +1.6	+2.6	+1.2
Eurozone	+1.7	+1.5	-0.5	(-0.6) -0.4	+1.0	**+0.7**
Japan	+4.2	-0.7	+1.9	(+2.0) +1.9	+1.7	+1.0
China	+10.3	+9.2	+7.8	(+7.5) +7.7	+7.3	+3.1

[Source – The Economist 9.11.13]

2. In early August, the new Governor of the Bank of England, Mark Carney, pledged to keep Base Rate at 0.5% until UK unemployment falls to a level of 7% from its current 7.8%. The Bank's own forecasts do not expect this to

happen until mid-2016. He also said, however, that this interest rate policy would be altered if inflation was threatening to get out of control.

3. In the United States, the rate of unemployment had been edging downwards, so that it was a great surprise to markets when the Chairman of the Federal Reserve, Ben Bernanke, announced in mid-September that he did not intend to start ‘tapering’ the rate of Quantitative Easing yet. It had been generally expected that the $85 bn per month of bond purchases would be reduced by $10-15bn from September, but the Fed decided (with some dissenters) that economic growth was not yet well enough established to permit this. In a mirror image of the markets’ reaction to the initial tapering announcement in May, equities and bonds rose sharply in the following days.

4. In Japan, Prime Minister Abe’s LDP party performed strongly in the Upper House elections in July, so that the LDP with its coalition partner now has a majority in both Houses of the Diet, and should be able to push through its structural reforms. He has since announced that he will implement the planned rise in consumption tax from 5% to 8% in April 2014, as a step towards tackling the country’s fiscal deficit.

5. The German Chancellor, Angela Merkel’s CDU party made big gains in the German elections in September, but her former coalition partners, the FPD, failed to reach the 5% threshold for representation in Parliament. The Chancellor is now in talks with the SPD about forming a Grand Coalition. In Australia Tony Abbott replaced Kevin Rudd as Prime Minister after a resounding win for his Liberal party over Labor in the election in September.

6. October began in rather bizarre fashion with the US Federal Government shutdown, after the House Republicans refused to pass the budget unless President Obama’s healthcare reforms were delayed or rescinded. This raised the spectre of disruption to the servicing of Treasury debt unless the deficit ceiling was increased on October 17th. In the event, Congress passed bills to fund the government until January 15th, and to extend the ability to borrow until February 7th. The problems have thus been deferred but not yet resolved.

Markets

7. **Equities** had risen by some 5% in July, but most of this gain had been surrendered by the end of August, partly on fears that the chemical attacks in Syria would provoke military intervention by the Western powers. When the UK parliament failed to back any military action, and President Obama also deferred a decision until Congress had discussed it, markets stabilised. The subsequent agreement with Russia and the West for Syria to dispose of its chemical weapons calmed investors’ nerves.

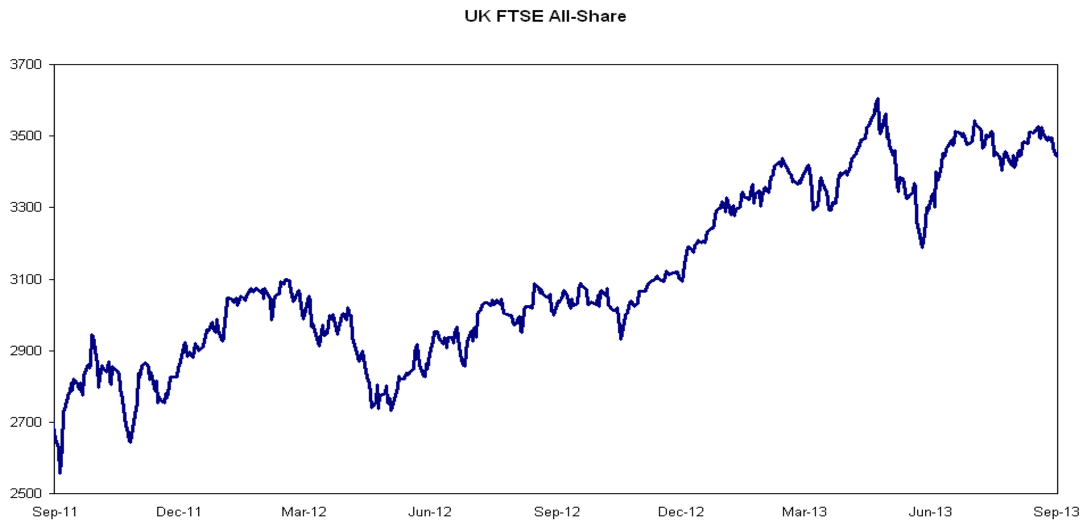
8. The recovery of equities in September was then stopped in its tracks by the Fed’s decision to delay tapering (see para 3), and markets ended September close to where they had started the month. As the following table shows, the UK and Europe were the only markets to gain ground (in sterling) during the

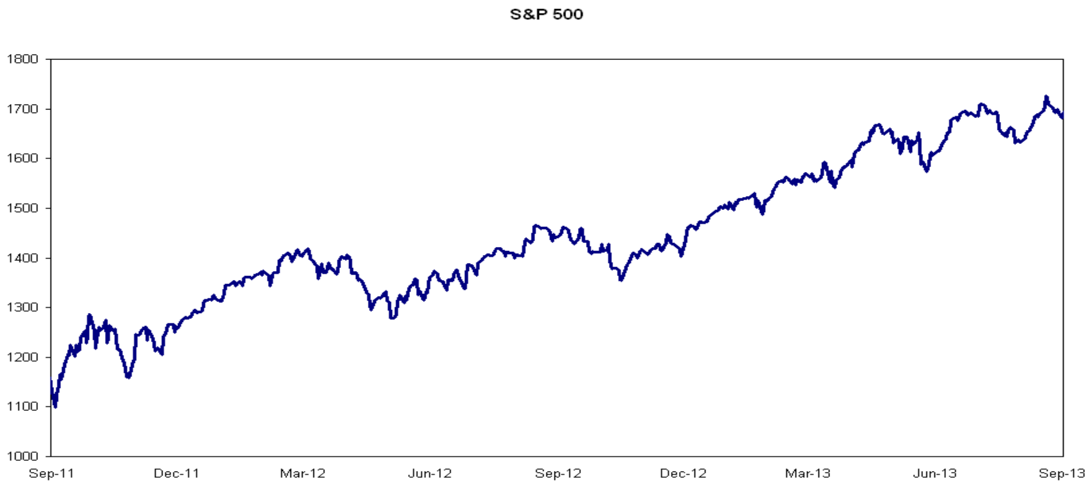
quarter, and Emerging Markets continued to lag behind all Developed Market regions.

	Capital return (in £, %) to 30.09.13		
Weight %	**Region**	**3 months**	**12 months**
100.0	**FTSE All-World Index**	**+0.6**	**+15.1**
50.3	FTSE All-World North America	-1.3	+15.8
8.8	FTSE All-World Japan	-0.5	+28.7
12.0	FTSE All-World Asia Pacific ex Japan	-0.5	+3.7
17.3	FTSE All-World Europe (ex-UK)	+6.6	+22.9
8.2	FTSE All-World UK	+4.1	+13.1
9.4	FTSE All-World Emerging Markets	-3.1	-2.8

[Source: FTSE All-World Review, September 2013]

9. Since the market correction in the summer of 2011, the UK equity market has gained 30% and the US market over 40%, in sterling terms, as shown in the graphs below.





10. There was very little dispersion in the performances of the different industrial sectors during the third quarter. As shown in the table below, Basic Materials recovered some of its earlier lost ground, but remains the weakest performer over the past year.

Capital return (in £, %) to 30.09.13		
Industry Group	**3 months**	**12 months**
Consumer Services	+1.5	+23.5
Industrials	+3.5	+23.2
Health Care	-1.0	+22.4
Financials	+0.2	+21.5
Consumer Goods	-1.6	+18.2
FTSE All-World	**+0.6**	**+15.1**
Technology	+1.3	+8.3
Telecommunications	-0.3	+6.5
Utilities	-3.4	+3.6
Oil & Gas	+0.1	+2.5
Basic Materials	+4.4	-3.0

[Source: FTSE All-World Review, September 2013]

11. Within the UK Equity market, the medium- and small-cap sectors have continued to outpace the FTSE 100 stocks by a wide margin, as shown in the table below.

(Capital only %, to 30.9.13)	3 months	12 months
FTSE 100	+ 4.0	+12.5
FTSE 250	+ 8.0	+27.0
FTSE Small Cap	+10.2	+30.8
FTSE All-Share	+ 4.7	+14.9

[Source: Financial Times]

12. **Government Bond** yields in US, UK and Germany rose for most of the quarter, with US and UK 10-year yields reaching the 3% level in mid-September. The Fed's surprise decision to delay the start of tapering caused an immediate fall in yields on the prospect of undiminished purchasing by the Fed for at least three more months. In Japan, by contrast, the Central Bank's programme of bond purchases is well underway, and government bond yields there have declined steadily.

10-year government bond yields (%)					
	Dec 11	Dec 12	Mar 2013	June 2013	Sept 2013
US	1.88	1.76	1.85	2.49	2.62
UK	1.98	1.85	1.78	2.45	2.73
Germany	1.83	1.32	1.29	1.73	1.78
Japan	0.98	0.79	0.57	0.86	0.69

[Source: Financial Times]

Currencies

13. The improved outlook for the UK economy has resulted in a strong move for sterling during September, and it registered gains against all the main currencies in the quarter.

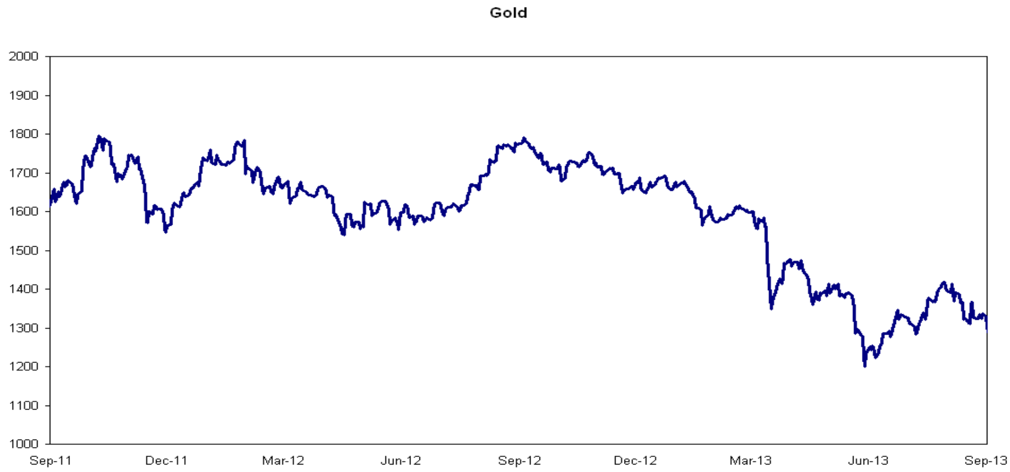
	30.06.13	30.09.13	£ move
$ per £	1.517	1.619	+ 6.7%
€ per £	1.167	1.196	+ 2.5%
Y per £	150.7	158.9	+ 5.4%

[Source: Financial Times]

Sterling has risen from below $1.50 during June to above $1.60 at the end of September – equalling its highest level against the dollar in the past two years as illustrated below.

Commodities

14. Gold rallied strongly during July, following its earlier weakness, and – together with oil – strengthened further on worries about the developing situations in Egypt and Syria. The removal of the threat of Western intervention in Syria allowed the price of both commodities to stabilise in September.



Property

15. **UK Property** values have made good progress during the quarter. According to the IPD Monthly Index, the total return on All Property was +2.9% - the strongest quarterly performance for three years. Office and Industrial both returned 3.7% and Retail 2.0%. The total return figures for the year to end-September are:

All Property	+6.5%
Office	+8.8%
Industrial	+8.6%
Retail	+4.2%

Outlook

16. After the temporary resolution of the US spending and debt impasse, and strong 3rd-quarter economic data from China, equity markets moved higher again. The All-World Index (in £) gained 4.7% during October, with Emerging Markets up almost 6%, but Japan up by only 1%. Bond prices also staged a relief rally, and recorded slight gains for the month. US, UK and German bond levels are sensitive to any new economic data, so that the strong US employment numbers for October caused an immediate rise in yields.

17. Provided the US fiscal situation is resolved soon, the improving economic outlook in the UK and Europe should underpin equity markets there, while the eventual start of tapering by the Federal Reserve – under the leadership of Janet Yellen – is likely to cause US bond yields to move higher. In the absence of any negative news on China's economic outlook or the Eurozone, I believe equities are well supported at current levels.

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November 11th, 2013

[All graphs supplied by Legal & General Investment Management]