AllenbridgeEpic
investment advisers

QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

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OXFORDSHIRE PENSION FUND COMMITTEE - 6 June 2014

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. The UK economy grew by 1.7% in 2013, well ahead of forecasts made even as recently as last summer, while the Office of Budget Responsibility expects 2.7% growth in 2014, and the Bank of England 3.4%. Meanwhile, the rate of UK inflation, as measured by CPI, fell to its target level of 2% in December and has since fallen to 1.6% for the year to March. Growth in the United States is on an improving path, while Europe looks to be coming out of its recession. The concern of European policymakers is the low rate of inflation, for which further measures may need to be taken. In Japan the effects of the 3% increase in consumption tax introduced on April 1 will be closely watched.

   (In the table below, bracketed figures show the forecasts at the time of the report to the March Committee)

Consensus real growth (%)					**Consumer prices latest (%)**
	2012	**2013**	**2014E**	**2015E**	
UK	-0.1	+1.7	(+2.7) +2.9	+2.5	**+1.6 (CPI)**
USA	+2.2	+1.9	(+2.9) +2.6	+3.0	+1.7
Eurozone	-0.5	-0.4	(+1.0) +1.2	+1.5	+0.9
Japan	+1.9	+1.7	(+1.6) +1.2	+1.3	+2.6
China	+7.8	+7.7	(+7.2) +7.3	+6.9	+2.8

[Source of Estimates: The Economist 10th May 2014]

2. In the UK Budget on March 19th, George Osborne reaffirmed the tight controls on government spending. While the fiscal deficit is expected to fall to 5.5% of GDP in 2014/15, there will not be a fiscal surplus until the 2018/19 tax year. The most significant change he announced was the removal of the obligation on retirees to buy an annuity with part of their pension pot. There were also large increases in the annual ISA allowance, and several measures to encourage individuals to save.

3. The new Chairman of the US Federal Reserve, Barbara Yellen, has continued to taper the amount of Quantitative Easing by $10bn per month; she also hinted in March that the first rise in US interest rates may occur in the first half of 2015, rather than at the end of 2015 as markets had anticipated. US employment data has been strong, with an average of 202,000 new jobs per month in the six months to March, while the rate of unemployment has fallen to 6.3%.

4. In Europe there have been changes in the Italian and French cabinets. In Italy the Prime Minister Mario Letta was ousted by party colleague Matteo Renzi, the youthful mayor of Florence, who has promised to introduce structural reforms to the Italian economy. Changes along these lines may also be imminent in France, where President Hollande responded to poor results for his Socialist Party in local elections by reshaping his cabinet, and installing Manuel Valls as Prime Minister.

5. After several days of increasingly violent street demonstrations in Kiev, President Yanukovich departed for Russia on February 22nd. The province of Crimea was then encircled by pro-Russian forces and, after a referendum on March 16th, annexed by Russia. There remains a distinct possibility that Russia will try to persuade the eastern part of Ukraine to re-align with Russia, in opposition to the wishes of Western European and US governments. Investors are concerned that further escalation could have an impact on the gas and oil supplies which Russia exports via Ukraine, as well as on trade with Russia. The EU and USA have begun to impose financial sanctions on Russia.

Markets

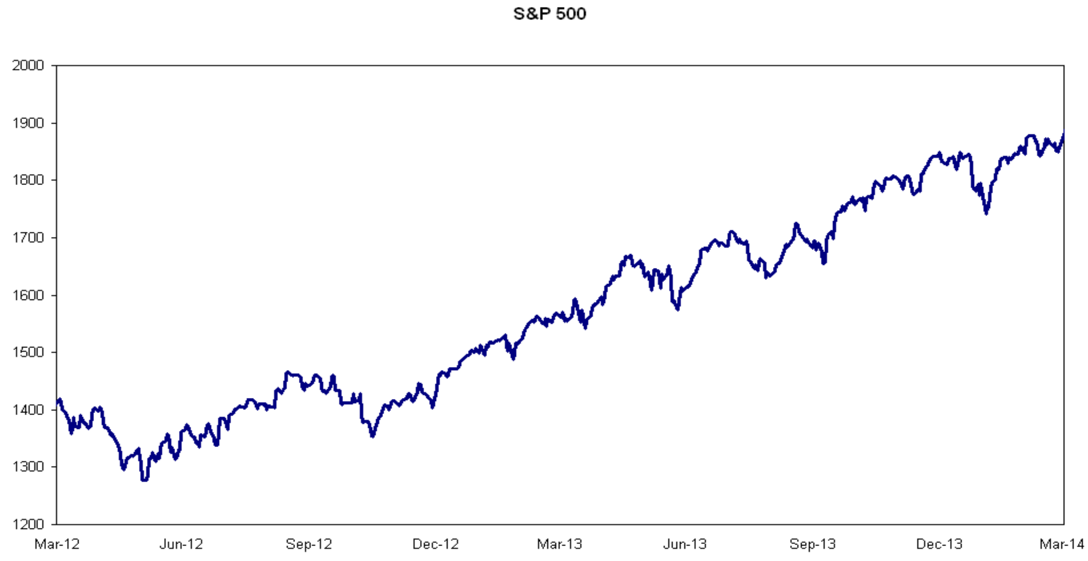
6. **Equity** markets ended the quarter little changed, although Japan was a notable faller, and the UK market weakened slightly. Emerging Markets recovered some of the losses they had suffered after the Argentine currency crisis in January, although they remain very sensitive to the Ukraine situation. Unsurprisingly Russian shares lost 16% in sterling terms during the quarter, but within Europe there were good gains from some of the peripherals - Greece (+17%), Ireland (+16%) and Italy (+14%). April saw very little net movement in equities, the only outlier being Japan which fell by 4%.

	Capital return (in £, %) to 31.03.14		
Weight %	**Region**	**3 months**	**12 months**
100.0	**FTSE All-World Index**	- **0.1**	**+ 4.0**
51.7	FTSE All-World North America	+ 0.7	+ 8.0
7.8	FTSE All-World Japan	- 6.8	- 3.4

11.6	FTSE All-World Asia Pacific ex Japan	- 0.2	- 9.3
17.9	FTSE All-World Europe (ex-UK)	+ 1.8	+11.8
7.8	FTSE All-World UK	- 2.4	+ 2.8
9.0	FTSE All-World Emerging Markets	- 1.1	- 13.5

[Source: FTSE All-World Review, March 2014]

In the US, the S&P 500 Index reached a new high of 1872 at the end of March, having risen 33% during the past two years.



Within the UK equity market, mid- and small-cap companies continued to out-perform the FTSE 100 shares, as shown in the following table.

(Capital only %, to 31.03.14)	**3 months**	**12 months**
FTSE 100	**- 2.2**	**+ 2.9**
FTSE 250	**+ 2.1**	**+16.9**
FTSE Small Cap	**+ 0.9**	**+17.5**
FTSE All-Share	**- 1.5**	**+ 5.2**

7. The strongest sectors during the quarter were Utilities (+6.2%) and Health Care (+4.9%), while Basic Materials (-1.4%) was again among the weakest sectors, and remains the laggard over the past 12 months.

Capital return (in £, %) to 31.03.14		
Industry Group	**3 months**	**12 months**
Technology	+2.2	+13.4
Health Care	+4.9	+12.3
Industrials	-0.8	+8.3
Consumer Services	-2.4	+ 6.7
FTSE All-World	**-0.1**	**+4.0**
Financials	-0.6	+3.2
Telecommunications	-3.5	+1.6
Utilities	+6.2	-1.0
Consumer Goods	-1.4	-1.2
Oil & Gas	-0.4	-1.7
Basic Materials	-1.4	-6.4

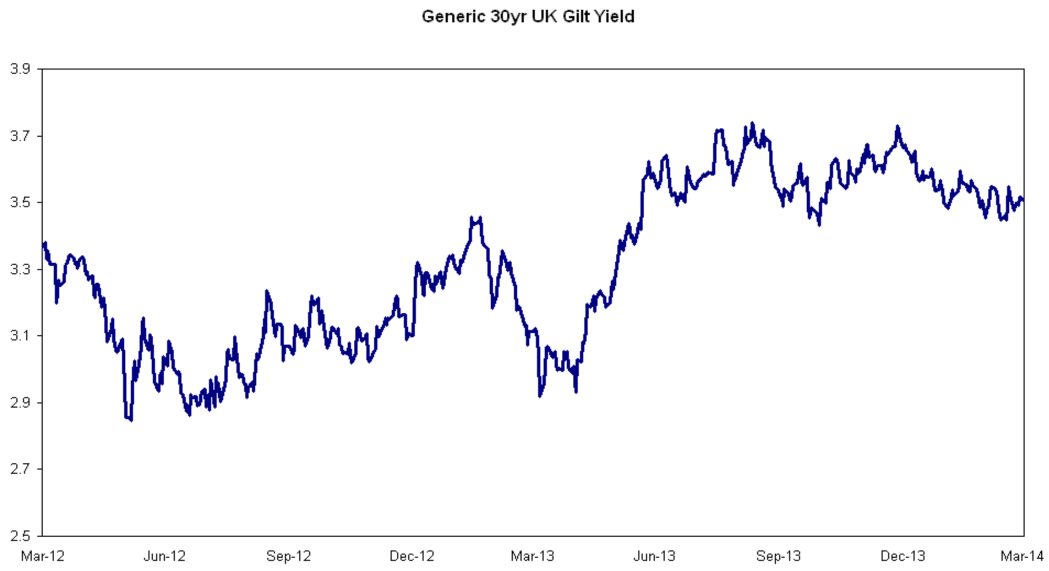
[Source: FTSE All-World Review, March 2014]

8. Contrary to expectations, **Government Bonds** were strong during the first quarter, with yields on 10-year UK, US and German bonds falling by 30-40 basis points (0.3 – 0.4%).
Bonds issued by Italy, Spain and Greece were in demand, and their yield differentials with German bunds narrowed even further. **Corporate Bonds** were also firm, and yields on sub-investment grade bonds fell to levels not seen since 2007.

10-year government bond yields (%)					
	Dec 11	**Dec 12**	**June 2013**	**Dec 2013**	**Mar 2014**
US	1.88	1.76	2.49	3.03	2.72
UK	1.98	1.85	2.45	3.04	2.73
Germany	1.83	1.32	1.73	1.94	1.57
Japan	0.98	0.79	0.86	0.74	0.65

[Source: Financial Times]

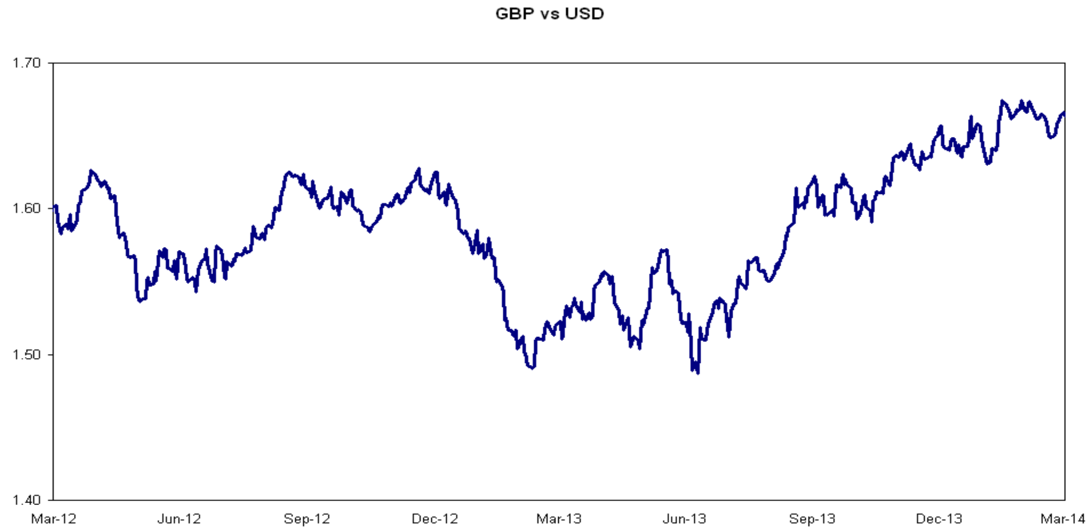
Even at the long end of the gilt market, the 30-year bond only yields 3.6%.



Currencies

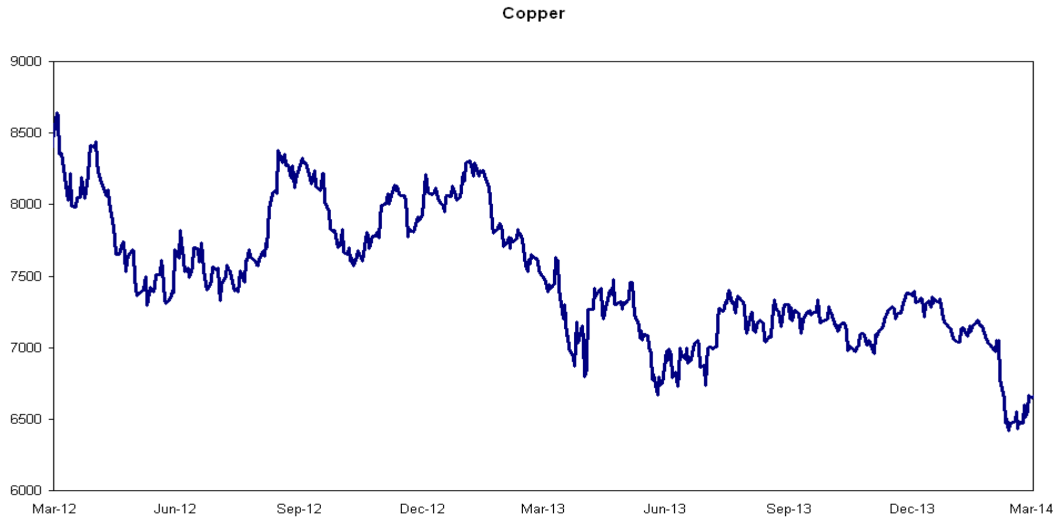
9. The pound gained slightly against the dollar and euro during the quarter, as the UK economic outlook improved. In early May the pound reached $1.70 – its highest level since 2010.

	31.12.13	**31.03.14**	**£ move**
$ per £	1.656	1.667	+ 0.7%
€ per £	1.202	1.210	+ 0.7%
Y per £	174.1	171.7	- 1.4%



Commodities

10. The **oil** price moved within a narrow range, while **gold** gained 8% to $1294, recouping most of its loss during the previous quarter. **Copper**, however, weakened sharply, as shown in the graph below. The main reason was the situation in China, where demand for copper was slowing but, more importantly, the use of copper by companies as collateral against loans led to selling as the credit market in China was tightened.



Property

11. The **UK Property** market continues to advance strongly, and one-year returns on Property are exceeding those on Equities for the first time for several years. The IPD UK Monthly Property All-Property Index to end-March 2014 gave a 12-month total return of **14.0%.** Sectoral returns were:

Retail	**+ 9.6%**
Office	**+18.9%**
Industrial	**+18.2%**

Outlook

12. The situation in Ukraine is likely to remain the focus of attention for some months to come, with the potential for weakness in European equities if the level of confrontation escalates. Elsewhere, economic data from China will be scrutinised closely for any sign of a slowdown in the economy, and the bond markets will be watching the US and UK central banks for hints about the timing of the first increase in interest rates. After the recent strength in most equity markets, and the falling yields on government and corporate bonds, it is easier to foresee setbacks in the next few months than further appreciation of asset values.

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May 9th, 2014 [All graphs supplied by Legal & General Investment Management]