QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

Q3 2014

10 November 2014

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OXFORDSHIRE PENSION FUND COMMITTEE - 5 DECEMBER 2014

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. UK economic growth slowed slightly to 0.7% growth in the third quarter, with unemployment falling to below 2 million; average wage growth, however, continues to lag the rate of inflation. Growth in the US was strong in Q2, but much of this was due to restocking of inventory, and preliminary Q3 numbers exceeded expectations. The Eurozone slowed further, with even Germany reporting negative growth, while Japan suffered from the after-effects of the April 1 consumption tax increase.

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

Consensus real growth (%)					**Consumer prices latest (%)**
	2012	**2013**	**2014E**	**2015E**	
UK	-0.1	+1.7	(+3.1) +3.0	+2.7	+1.2 (CPI)
USA	+2.2	+1.9	(+2.0) +2.2	+2.9	+1.7
Eurozone	-0.5	-0.4	(+1.1) +0.8	+1.2	**+0.4**
Japan	+1.9	+1.7	(+1.4) +0.9	+1.1	**+**3.3
China	+7.8	+7.7	(+7.3) +7.3	+7.0	+1.6

[Source of estimates: The Economist 8th November, 2014]

2. In early September the European Central Bank announced a further cut in base rate, from 0.15% to 0.05%, and lowered its negative interest rate on central bank deposits to – 0.2%, in a bid to prevent the Eurozone from slipping into deflation. The ECB also said it would start buying asset-backed securities, and buy debt from banks. Details of this programme are awaited. Meanwhile the Bank of England hinted in August that the weakness in UK wage growth could cause a delay in the first rise in UK base rate into early-2015. The subsequent slowdown in CPI inflation, and the weakness of the European economy**,** have moved this expectation into the second half of 2015.

3. Towards the end of October, the US Federal Reserve confirmed that it would end its purchases of bonds under the Quantitative Easing programme. Only a day later, the Bank of Japan announced that it would step up its QE operation, with the aim of increasing Japan's monetary base to Y80 trn (compared with the previous target of 60-70trn), primarily by purchasing Japan Government Bonds.

4. Geopolitical tensions have increased sharply in several different regions. The shooting-down of passenger airline MH17 over Eastern Ukraine on July 17th has resulted in a tightening of the sanctions imposed by the EU and the US on Russia's financial, energy and defence sectors. The rapid advance of Islamic State forces in Iraq provoked a response from the US in the form of airstrikes to protect endangered minorities there, and the US later extended their operations, with regional allies, to Northern Syria. In late September the UK government agreed to join these actions in Iraq, but not in Syria. In Hong Kong, protesters took to the streets for over a week to demand greater democracy in the election of the Chief Executive of the region.

5. The Scottish Referendum on September 18th resulted in a 55-45% defeat for the independence campaign, but extracted promises of enlarged powers of devolution from Westminster. The French Cabinet was dissolved and re-formed without three left-wingers who had resigned because they disagreed with the country's economic policy. The Brazilian stockmarket reacted badly to President Rousseff's narrow re-election win.

Markets

6. With the exception of the UK and Europe, **Equity** markets gained further ground during the quarter, although Emerging Markets retreated in September, losing 5%. The sharp fluctuations in equities during October are described in para 14 below.

	Capital return (in £, %) to 30.09.14		
Weight %	**Region**	**3 months**	**12 months**
100.0	**FTSE All-World Index**	**+2.6**	**+9.0**
53.1	FTSE All-World North America	+5.5	+16.3
8.0	FTSE All-World Japan	+2.3	-0.9
11.6	FTSE All-World Asia Pacific ex Japan	+1.4	+3.4
16.6	FTSE All-World Europe (ex-UK)	-2.9	+2.0
7.6	FTSE All-World UK	-1.8	+2.2
9.2	FTSE All-World Emerging Markets	+2.0	+3.6

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

7. In the UK equity market, the large-cap stocks – as represented by the FTSE 100 index – continued to keep pace with the mid-and small-cap stocks, so that there is now very little difference in their one-year returns.

(Capital only %, to 30.09.14)	**3 months**	**12 months**
FTSE 100	**- 1.8**	**+2.5**
FTSE 250	**-2.2**	**+3.2**
FTSE Small Cap	**-1.4**	**+4.1**
FTSE All-Share	**-1.8**	**+2.6**

[Source: Financial Times]

8. Globally, the Technology and Health Care sectors have been by far the strongest performers over 3 and 12 months, buoyed up by corporate activity in both areas, while Basic Materials and Oil & Gas continue to be laggards.

Capital return (in £, %) to 30.09.14		
Industry Group	**3 months**	**12 months**
Technology	+8.5	+25.8
Health Care	+8.8	+22.9
FTSE All-World	**+2.6**	**+9.0**
Utilities	-0.2	+8.8
Industrials	+1.6	+7.3
Consumer Services	+3.3	+6.9
Financials	+3.3	+6.8
Telecommunications	+4.0	+5.3
Oil & Gas	-5.2	+5.0
Consumer Goods	+0.5	+3.1
Basic Materials	-1.8	-0.1

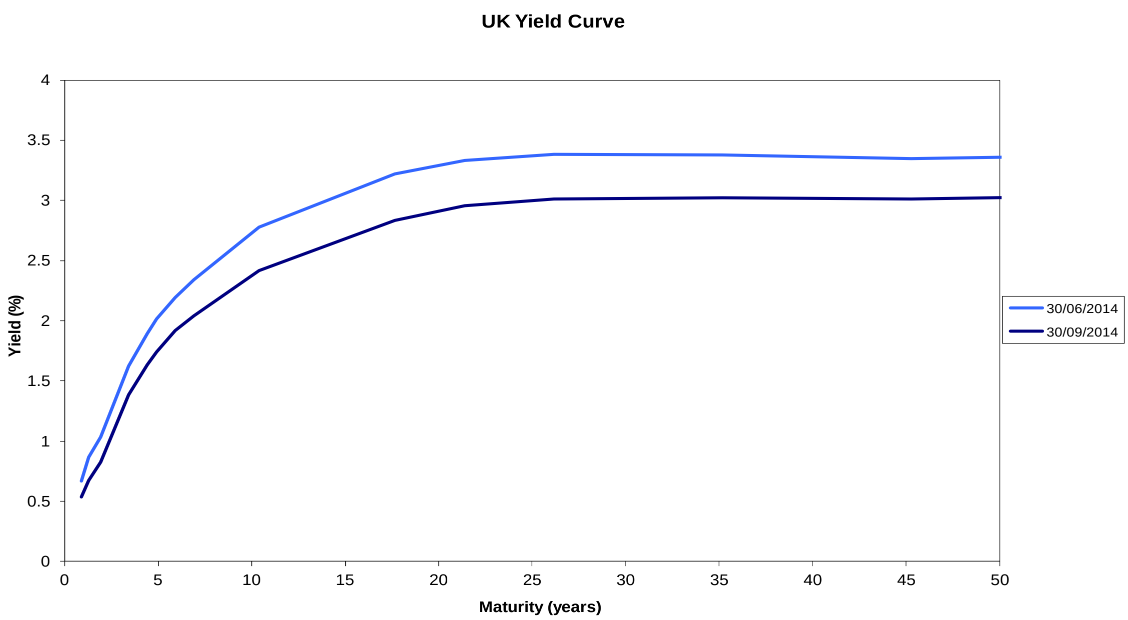
[Source: FTSE All-World Review, September 2014]

9. **Government Bonds** have appreciated, with yields falling on consideration of slower growth and lower levels of inflation, especially in Continental Europe, where 10-year German Bund yields fell below 1%.

10-year government bond yields (%)					
	Dec 11	**Dec 12**	**Dec 13**	**June 14**	**Sept 14**
US	1.88	1.76	3.03	2.52	2.49
UK	1.98	1.85	3.04	2.68	2.43
Germany	1.83	1.32	1.94	1.25	**0.95**
Japan	0.98	0.79	0.74	0.57	0.53

[Source: Financial Times]

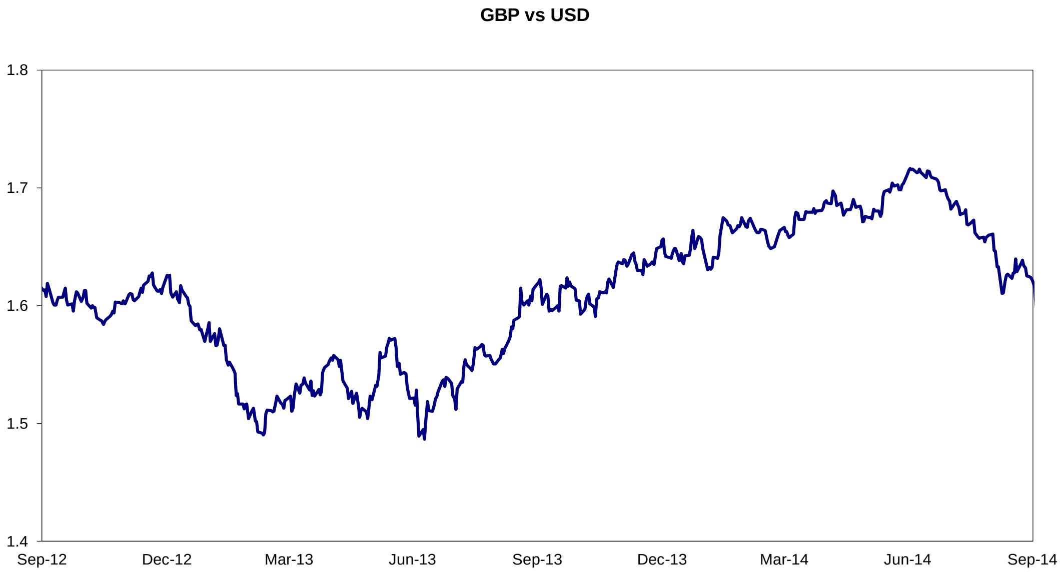
10. In the UK, yields at all durations fell significantly during the quarter, as the graph below illustrates.



Currencies

11. The dollar rebounded sharply against all the other major currencies, in part as a 'safe haven' in the face of the military action in Iraq and Syria and the tense relationship with Russia. The pound weakened ahead of the Scottish referendum when it appeared that the independence campaign would win, and then remained weak when the Bank of England discouraged the idea of an early rise in interest rates.

				£ move	
	30.9.13	**30.06.14**	**30.09.14**	**3m**	**12m**
$ per £	1.619	1.710	1.621	- 5.2%	+ 0.1%
€ per £	1.196	1.249	1.283	+ 2.7%	+ 7.3%
Y per £	158.9	173.2	177.8	+ 2.7%	+11.9%



Commodities

12. The most unexpected development was the weakening of the oil price. The risk of interruption to Iraqi oil production would normally have caused a rise in the oil price, but Iraqi oil continued to flow, and supplies from US and Libya increased. Saudi Arabia also appears reluctant to curb supply in order to maintain prices. The price of Brent crude fell 16% during the quarter, and by a further 9% during October. Gold has also been weak, falling below $1200/oz and touching its lowest level since April 2010.

Property

13. The UK Property market maintained its recent rapid rate of growth, with a total return of 4.7% in the third quarter. The IPD UK Monthly Property Index to end-September 2014 shows 12-month total returns of :

All Property	**+19.7%**
Retail	**+ 14.5%**
Office	**+ 25.2%**
Industrial	**+ 24.8%**

Markets since end-September

14. October saw greatly increased volatility in equity and bond markets, in contrast to the relative calm since the start of the year. The release of data showing a slowdown in the rate of Chinese growth, and the spectre of recession in the Eurozone, mixed with concerns over the possible spread of the ebola virus to Europe and the US, combined to create nervousness among equity investors. By the middle of October, UK and US equity markets had fallen by 5%, while losses in Continental Europe and Japan extended to 10%. Meanwhile government bonds were strong, with UK and US 10-year yields falling by 0.25%. The second half of October was a mirror-image of the first, as equities recovered all their earlier falls. In Japan the news of the BoJ's increased QE targets caused an immediate bounce of 5% in the Nikkei Index, with further gains in the following days. The Yen, meanwhile, weakened to Y112/ $ on the news.

Outlook

15. Equity markets have experienced their first bout of nerves this year, and, as is often the case, there was no single cause for the change of sentiment. The ending of Quantitative Easing by the US Federal Reserve at the end of October had been flagged well in advance, but this has acted as a reminder that one of the safety nets is being removed, and that the US economy could slow down as a result. The subsequent response of Japanese equities to the revised BoJ policy shows that Central Bank actions still have a strong influence on equity and currency markets.

16. A sharp fall in the price of oil would normally be welcomed by equity markets, as lowering the cost of a key input, but instead its weakness is seen as a symptom of slowing industrial activity globally. On balance the fall in the oil price is expected to improve corporate profit levels, and thereby give support to equity prices, but with so many geopolitical issues looming, I continue to see little scope for further rises in equity markets.

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November 10th, 2014

[All graphs supplied by Legal & General Investment Management]