QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

Q1 2015

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OXFORDSHIRE PENSION FUND COMMITTEE – JUNE 2015

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. The slowdown in the US economy continued in Q1, when the rate of growth was only 0.2% *annualised.* Combined with slowing jobs data, this appeared likely to delay the timing of the first rise in US interest rates. The UK reported just 0.3% growth in Q1, compared with +0.6% in the previous quarter. The Eurozone is showing signs of a slow recovery, while China's official growth rate of 7% p.a. is looking to be at odds with other measures of activity within the economy. The fall in the oil price has (temporarily) reduced inflation to zero in the UK and North America, thereby joining the Eurozone - where weak consumer demand has been the major factor.

(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**	**2014**	**2015E**	**2016E**	
UK	-0.1	+1.7	+2.8	+2.5 (+2.6)	+2.4	+0.0 (CPI)
USA	+2.2	+1.9	+2.4	+2.6 (+3.3)	+2.5	-0.1
Eurozone	-0.5	-0.4	+0.8	+1.5 (+1.2)	+1.9	+0.0
Japan	+1.9	+1.7	+0.3	+0.8 (+1.1)	+1.5	+2.3
China	+7.8	+7.7	+7.4	+6.9 (+7.1)	+6.8	+1.4

[Source of estimates: The Economist, May 9th, 2015]

2. In the UK Budget on March 18th, George Osborne relaxed some of the austerity measures for 2019 which he had announced in the Autumn Statement. The longer-term spending forecasts were also helped by estimated interest savings of £41bn over the next five years due to the lower costs of servicing government debt. Measures to help savers included the waiver of tax on the first £1,000 of interest income, above-inflation rises in the income tax thresholds, and matching finance for those saving via ISAs for a

deposit on their first home. The Budget as a whole was seen as paving the way for the impending General Election.

3. The European Central Bank embarked on its programme of Quantitative Easing in March, intending to purchase €60bn of government and private sector bonds per month until September 2016. This has led to the weakening of the Euro, which has in turn boosted the outlook for European companies which export outside the Eurozone.

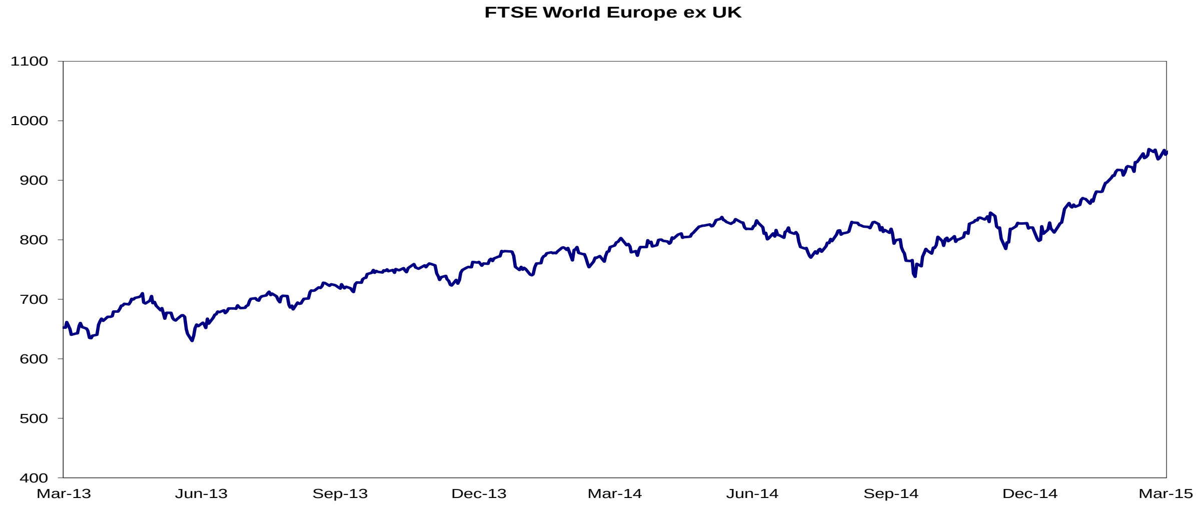
4. In February the new Greek government was granted a four-month extension to its bailout on the condition that it agreed suitable economic reform measures. These have not yet been forthcoming to the satisfaction of the European lending institutions, and although the combative Greek Minister of Finance has been sidelined from the negotiations, it is still not clear how Greek will be able to meet its immediate repayment schedule.

Markets

5. **Equity** markets rose steadily through the quarter, although there were large regional differences. The UK continued to lag other markets, while Japan and Pacific Basin stocks were particularly strong. Continental European equities gained 10% in sterling terms, spurred on by the weaker Euro and the start of Quantitative Easing by the ECB.

	Capital return (in £, %) to 31.3.15		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**+7.0**	**+16.2**
53.7	FTSE All-World North America	+5.4	+22.6
8.4	FTSE All-World Japan	+15.4	+24.7
11.9	FTSE All-World Asia Pacific ex Japan	+9.0	+16.5
16.2	FTSE All-World Europe (ex-UK)	+10.2	+3.5
7.0	FTSE All-World UK	+3.4	+2.8
9.1	FTSE All-World Emerging Markets	+6.7	+12.9

[Source: FTSE All-World Review, March 2015]



6. Health Care stocks were again buoyant on takeover activity in the sector; Oil & Gas was still depressed by the weaker oil price, but Basic Materials regained some of the ground lost during 2014.

Capital return (in £, %) to 31.3.15		
Industry Group	**3 months**	**12 months**
Health Care	+12.6	+33.3
Technology	+6.6	+28.7
Consumer Services	+10.0	+26.1
Consumer Goods	+8.9	+18.5
FTSE All-World	**+7.0**	**+16.2**
Industrials	+7.7	+14.8
Financials	+5.2	+14.6
Telecommunications	+6.4	+11.1
Utilities	-0.6	+8.6
Basic Materials	+6.0	+1.8
Oil & Gas	+1.1	-9.5

[Source: FTSE All-World Review, March 2015]

7. Within the **UK equity** market, the mid- and small-cap sectors were relatively strong. The FTSE 100 Index crossed the 7,000 level for the first time, thereby surpassing the peak previously reached at the end of 1999.

(Capital only %, to 31.3.15)	3 months	12 months
FTSE 100	+3.2	+2.6
FTSE 250	+6.2	+5.0
FTSE Small Cap	+5.3	+2.8
FTSE All-Share	+3.7	+3.0

[Source: Financial Times]

8. **Government bond** yields in Europe and North America fell yet further during the quarter, as the table of 10-year yields below shows. At shorter durations, many bonds in Germany, Switzerland and elsewhere were actually offering *negative* yields to maturity. The ECB's QE programme and falling levels of inflation were the main contributory factors.

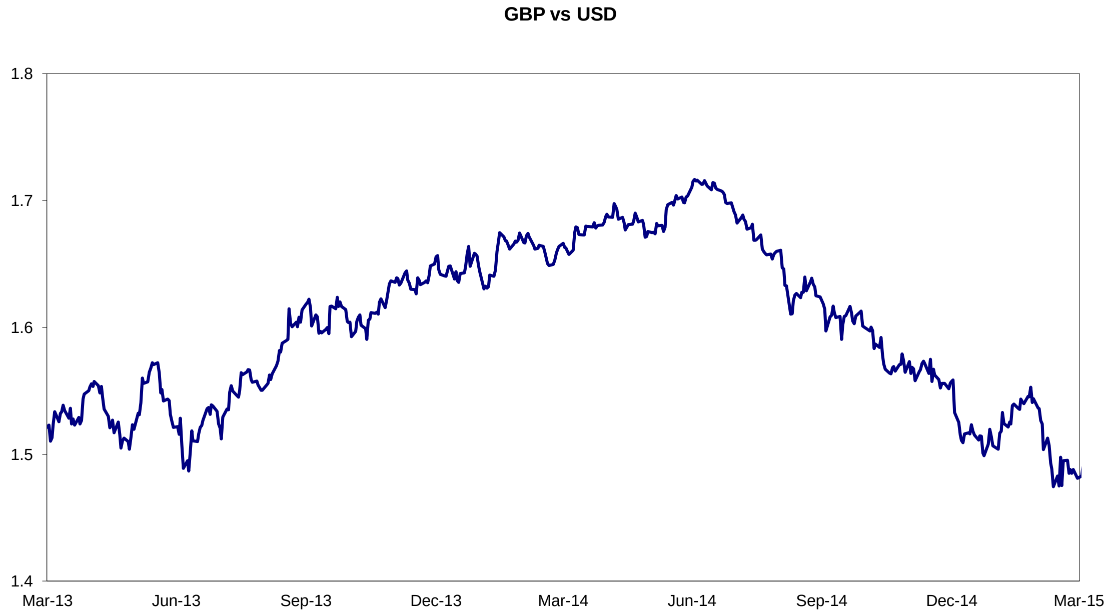
10-year government bond yields (%)					
	Dec 12	**Dec 13**	**Sept 2014**	**Dec 2014**	**Mar 2015**
US	1.76	3.03	2.49	2.17	1.94
UK	1.85	3.04	2.43	1.76	1.70
Germany	1.32	1.94	0.95	0.54	0.18
Japan	0.79	0.74	0.53	0.33	0.41

[Source: Financial Times]

Currencies

9. Expectations of an early rise in US interest rates pushed the dollar higher against all other currencies, although it has given back some of these gains during April as the Fed has indicated the first interest rate rise could be delayed somewhat. The Euro was extremely weak against sterling also, as fears of a Greek crisis resurfaced.

				£ move	
	31.3.14	**31.12.14**	**31.3.15**	**3m**	**12m**
$ per £	1.667	1.559	1.485	- 4.7%	- 10.9%
€ per £	1.210	1.289	1.382	+7.2%	+14.2%
Y per £	171.7	186.9	178.0	- 4.8%	+ 3.7%



Commodities

10. During January, crude oil prices continued their downward path, with Brent Crude falling as low as $47 per barrel, but by the end of March it had regained its end-December level of $55, and in April it advanced further to $65. Copper followed a similar course to oil, recovering strongly from its January lows.

Property

11. The **UK property** market again recorded strong growth in the quarter, but with Retail still lagging well behind Office and Industrial properties.

	3-month	**12-month**
All Property	**+ 3.0%**	**+18.3%**
Retail	**+ 1.9%**	**+13.3%**
Office	**+ 4.0%**	**+22.9%**
Industrial	**+ 3.6%**	**+22.7%**

[Source: IPD Monthly Index of total returns, March 2015]

Outlook

12. In April and the early days of May, the price of oil has risen sharply, to stand almost 50% above its mid-January low. This in turn has caused government bond yields to rise from the extraordinarily low levels they had reached in March, and caused nervousness in equity markets. This may mark the start of the long-awaited ‘normalisation’ process in equity and bond markets.

13. Meanwhile, the intransigence of the Greek government in its negotiations over loan terms could come to a head shortly, and set off renewed fears of a break-up of the eurobloc.

14. The surprise overall majority achieved by the Conservative party in the UK General Election has removed the policy uncertainties which a coalition might have created, and the initial reaction of UK Equities was a 2.5% rise on the following day. Looking ahead, the Conservatives' pledge to hold an 'in-out' referendum on the UK's continuing membership of the EU is likely to create renewed uncertainty as 2017 approaches.

15. The pace of the rise in equity markets since the start of 2015 continues to be at odds with the extremely low level of sovereign bond yields – the former implying healthy growth in corporate profits, while the latter is more consistent with economic slowdown and muted inflation. At current levels, equity markets continue to look fully-valued.

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May 14th, 2015

[All graphs supplied by Legal & General Investment Management]