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QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

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PENSION FUND COMMITTEE – 4 SEPTEMBER 2015

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. Early in June the OECD cut its forecast of global growth in 2015 from 3.7% to 3.1%, due largely to a revision in US growth from 3.1% to just 2.0%, and a 0.3% reduction in its estimate for China. In the event, the US produced quarterly growth of 0.6% in the second quarter, and the non-farm payroll growth has been running at a healthy 200,000 per month. The latest indications from the Federal Reserve are for the first rise in US interest rates to take place in September. Although the Chinese economy is still officially forecast to grow by 7% in 2015, supporting data such as power consumption and luxury spending suggest a slower rate of growth.

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

Consensus real growth (%)						**Consumer prices latest (%)**
	2012	**2013**	**2014**	**2015E**	**2016E**	
UK	-0.1	+1.7	+2.8	+2.4 (+2.5)	+2.4	+0.0 (CPI)
USA	+2.2	+1.9	+2.4	+2.6 (+2.6)	+2.7	+0.1
Eurozone	-0.5	-0.4	+0.8	+1.4 (+1.5)	+1.7	+0.2
Japan	+1.9	+1.7	+0.3	+0.9 (+0.8)	+1.6	+0.4
China	+7.8	+7.7	+7.4	+6.9 (+6.9)	+6.7	+1.4

[

[Source of estimates: The Economist, August 8th 2015]

2. The tortuous progress of **Greece**'s negotiations with its creditors has been the dominant story in financial markets during recent months. With its existing (second) bailout expiring at the end of June, and with an IMF loan of €1.6bn being repayable at the same time, there was a general apprehension that a default by Greece would trigger its exit from the Eurozone. After several breakdowns in the talks, the Greek side appeared

in mid-June to be tightening its austerity proposals towards the terms demanded by its creditors, but the Greek Prime Minister suddenly announced on June 27th that he would call a referendum on the bailout terms then on offer (even though the terms officially lapsed before the July 5th referendum). Meanwhile, the European Central Bank was supplying emergency liquidity to the Greek banking system, so that the banks – which had rationed daily withdrawals – could cope with the demands for cash from the Greek public.

3. The referendum resulted in a 60% vote against the bailout terms, and the controversial Finance Minister Mr Varoufakis had resigned immediately afterwards. Within a week, however, the Greek negotiators had agreed to accept substantially the same terms subject to the approval of the Greek parliament. This was achieved while the ruling Syriza party remained in power. After a 5-week closure the Greek stockmarket re-opened, and shares fell sharply for several days. The Greek government hopes to finalise the latest rescue package by August 18th, in time to repay an IMF loan, but the domestic political and economic outlook remains fragile.

4. The biggest surprise in the **UK Budget** on July 8th was the announcement of a new National Living Wage, starting at £7.20 per hour for over-25s in 2016, and rising to more than £9 per hour by 2020. This measure provoked differing views as to whether it would produce a real rise in incomes for the lower-paid, or encourage employers to shed jobs by substituting automation for what are lower-skilled jobs at present. Other Budget measures included plans to reduce benefit payments, increases in income tax thresholds and cuts in the rate of Corporation Tax from 20% to 19% in 2017 and to 18% in 2018.

5. Official forecasts showed the UK's budget deficit falling to 3.7% of GDP this tax year, and continuing to fall until a surplus emerges in 2019-20, one year later than previously planned. GDP growth is forecast to be steady at 2.4% annually each year until 2018, while inflation, as measured by CPI, is forecast to be below 1% until the end of 2016, and to remain in the 1-2% range for the subsequent four years.

6. The gyrations of the **Chinese domestic stockmarket** hit the headlines in June and July. Having risen by 150% in the previous year, the Shanghai Composite Index then started to fall rapidly in mid-June, and had fallen by some 30% from its peak by mid-July. The government tried a whole battery of measures to shore up the market – cutting interest rates, injecting reserves into the banking system, banning short-selling of index futures and, finally, central bank-funded purchases of index futures. The market level has stabilised since mid-July – partly because many shares suspended trading – but this period of calm may be only temporary. The direct effect on other stockmarkets is likely to be minimal, but the effect on domestic consumption may be more significant.

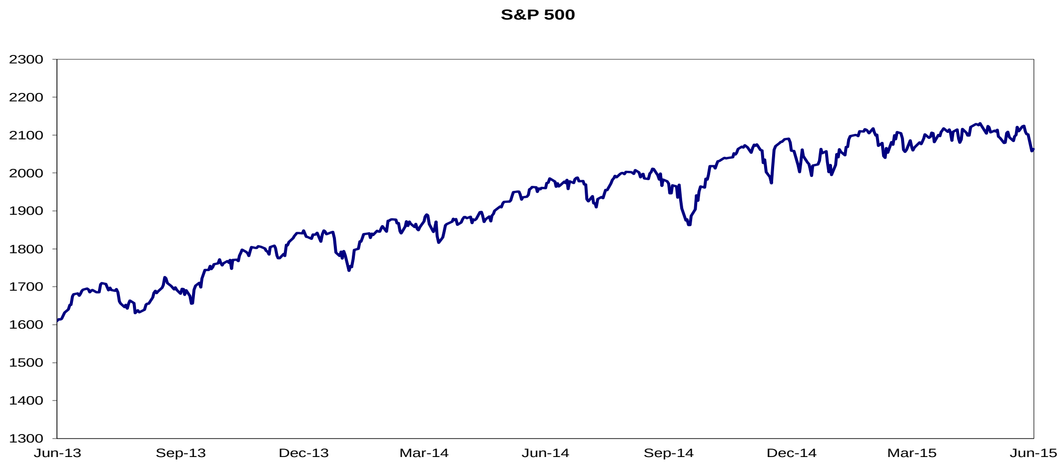
Markets

7. The All-World Equity Index had its first significant quarterly fall for over two years, although this was exaggerated by the strength of the £ against other currencies (see para 11). Despite making up some ground, the UK market remains the weakest over the past year, with Continental Europe only slightly ahead of it.

	Capital return (in £, %) to 30.6.15		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**-5.8**	**+7.6**
53.5	FTSE All-World North America	-5.9	+12.7
8.7	FTSE All-World Japan	-2.5	+16.8
11.9	FTSE All-World Asia Pacific ex Japan	-7.3	+5.3
15.9	FTSE All-World Europe (ex-UK)	-7.4	-2.5
7.2	FTSE All-World UK	-3.4	-2.9
9.3	FTSE All-World Emerging Markets	-4.9	+3.5

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

The S&P 500 Index has traded in a narrow range this year, close to its all-time peak.



8. There was little dispersion between the different sectors during the quarter, so that Health Care, Consumer Services and Technology continue to be the leaders over the past year. With the oil price having halved, it is no surprise that Oil & Gas has been by far the weakest sector during the past twelve months.

Capital return (in £, %) to 30.6.15		
Industry Group	**3 months**	**12 months**
Health Care	- 4.2	+25.3
Consumer Services	-5.4	+19.0
Technology	-6.8	+15.3
Financials	-4.5	+ 9.7
Consumer Goods	-6.3	+ 9.0
FTSE All-World	**-5.8**	**+ 7.6**
Industrials	-7.2	+ 6.3
Telecommunications	-4.1	+ 6.1
Utilities	-8.8	- 4.4
Basic Materials	-7.3	- 6.7
Oil & Gas	- 6.3	-21.7

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

9. In the **UK Equity** market, the mid- and small-cap sectors continued to perform more strongly than the large-caps

(Capital only %, to 30.6.15)	**3 months**	**12 months**
FTSE 100	**- 3.7**	**- 3.3**
FTSE 250	**+ 2.6**	**+11.5**
FTSE Small Cap	**+ 1.7**	**+ 5.3**
FTSE All-Share	**- 2.5**	**- 0.8**

[Source: Financial Times]

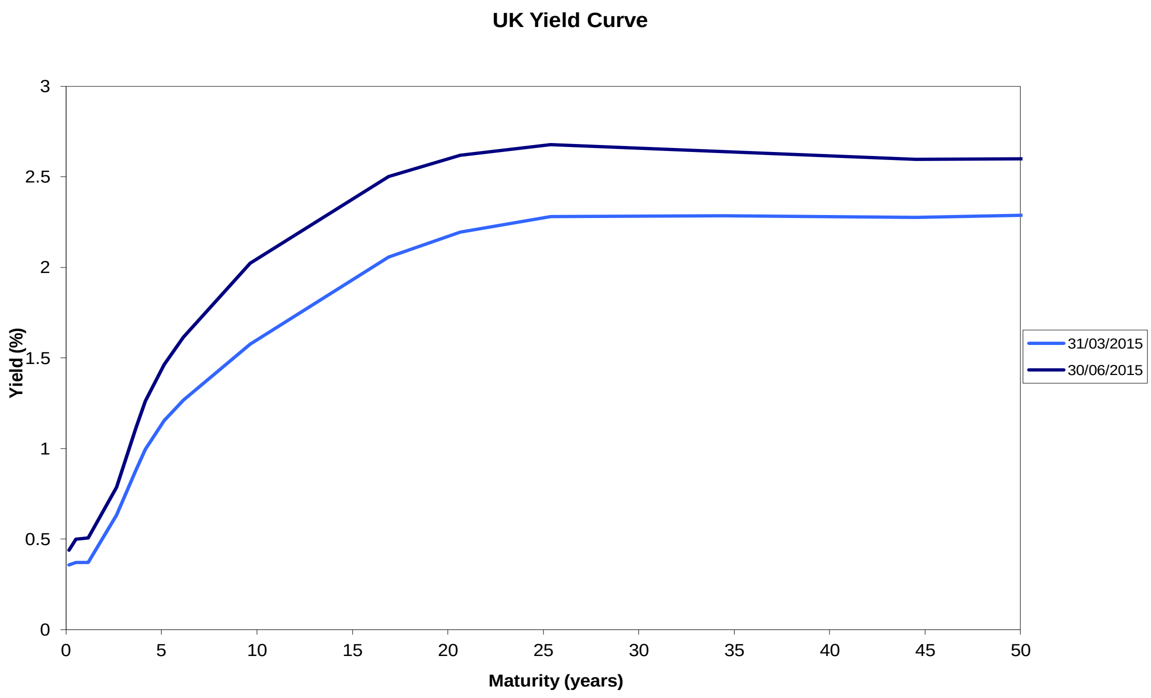
10. **Government Bonds** reversed their sharp appreciation seen in the first quarter, and yields on the 'safe haven' bonds ended June higher than their

end-December levels. Yields on peripheral European bonds rose, however, on fears of a Greek default.

10-year government bond yields (%)					
	Dec 12	**Dec 13**	**Dec 2014**	**Mar 2015**	**June 2015**
US	1.76	3.03	2.17	1.94	2.32
UK	1.85	3.04	1.76	1.70	2.14
Germany	1.32	1.94	0.54	0.18	0.77
Japan	0.79	0.74	0.33	0.41	0.45

[Source: Financial Times]

The rise in yields throughout the UK yield curve can be seen on the graph below.

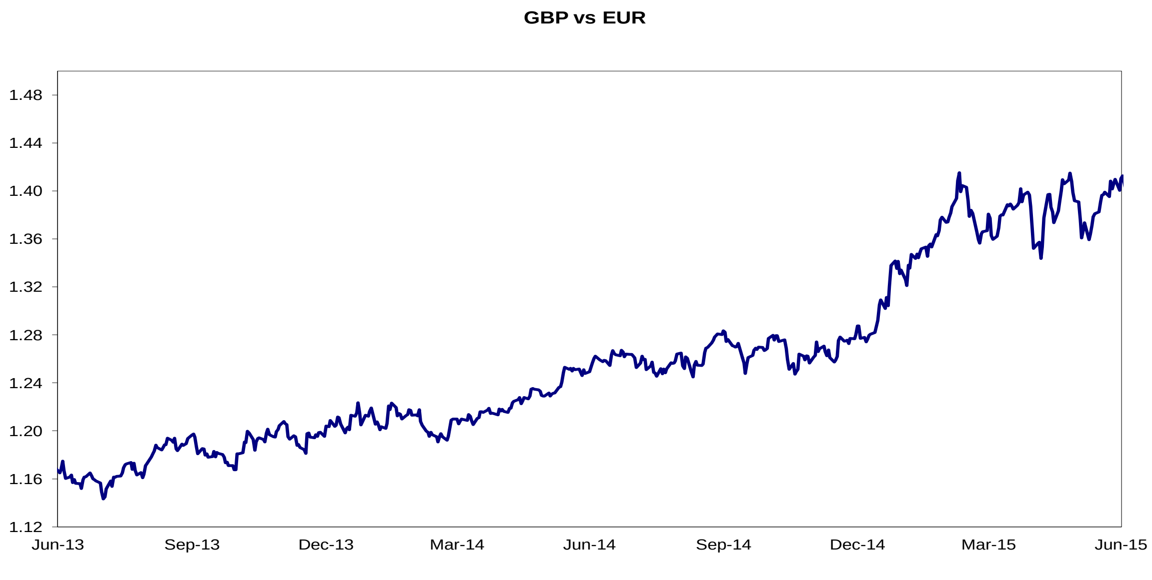


Currencies

11. Sterling rose against all the other major currencies, as the uncertainty surrounding a possible hung parliament was dispersed by the decisive outcome of the UK General Election.

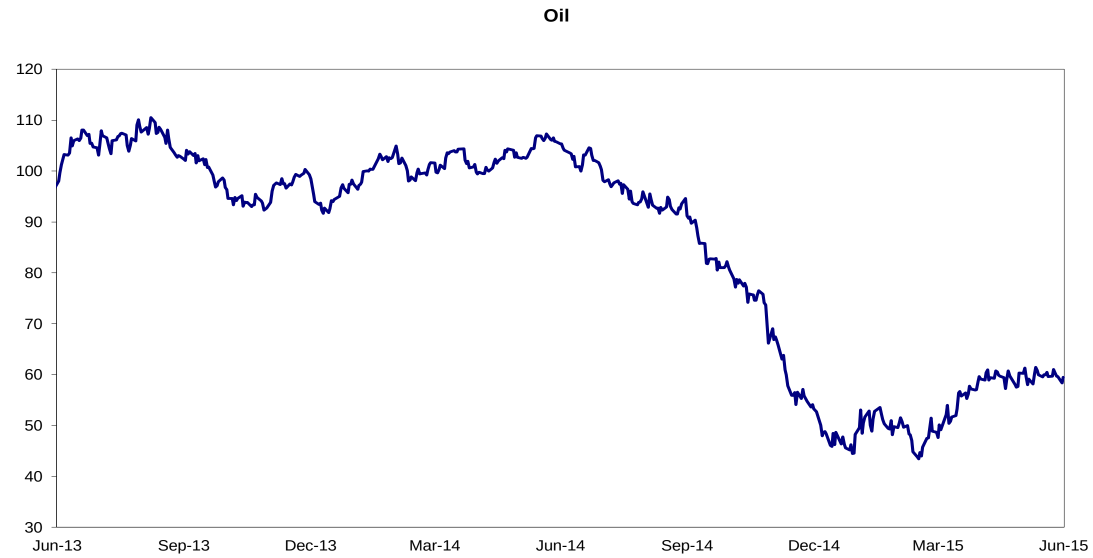
	30.6.14	31.3.15	30.6.15	£ move 3m	12m
$ per £	1.710	1.485	1.573	+5.9%	- 8.0%
€ per £	1.249	1.382	1.412	+2.2%	+13.0%
Y per £	173.2	178.0	192.4	+8.1%	+11.1%

At above 1.40, the pound stands at its highest level against the Euro for many years.

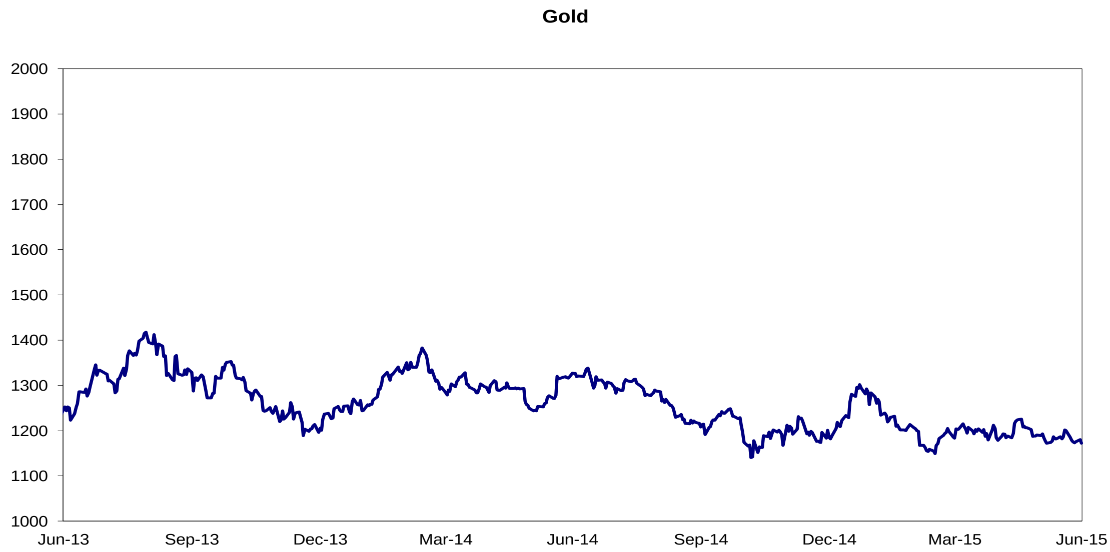


Commodities

12. Although the **oil** price gained during the quarter – Brent Crude rose from $55 to $63 – the following weeks saw a sharp reversal, with the price falling back to just $49 in early August. **Gold** fell to five-year lows as inflation became muted worldwide.



Oil
120
110
100
90
80
70
60
50
40
30
Jun-13
Sep-13
Dec-13
Mar-14
Jun-14
Sep-14
Dec-14
Mar-15
Jun-15



Gold
2000
1900
1800
1700
1600
1500
1400
1300
1200
1100
1000
Jun-13
Sep-13
Dec-13
Mar-14
Jun-14
Sep-14
Dec-14
Mar-15
Jun-15

Property

13. **UK Property** continued to report steady gains, with the Office and Industrial sectors once more outpacing Retail Property.

	3-month	12-month
All Property	+3.6%	+16.7%
Retail	+2.2%	+11.3%
Office	+5.2%	+21.8%
Industrial	+4.4%	+20.9%

[IPD Monthly Index of total returns, June 2015]

Outlook

14. With the first interest rate rise in the United States now imminent, markets will start to become accustomed to gradual monetary tightening – in US and UK if not elsewhere. After such a long period of zero short rates, this next phase should not come as a surprise to investors. As bond yields move further upwards, however, some investors who had been seeking out equities for their dividend yields may switch back to the fixed-income market. With this background, equity markets look unlikely to advance from current levels.

15. While the next Greek bailout may be concluded in August, the underlying state of their economy is deteriorating, and the political consequences of the austerity measures could be severe. The Eurozone may keep its membership intact for the present, but the inherent problems of the single-currency region will continue.

16. The future course of the oil price remains unpredictable, and while cheaper energy is a boon for consumers and for oil-importing countries, it will impact severely on oil-exporters (notably Russia and Venezuela) and cost jobs in the exploration industries as uneconomic projects are postponed or closed down.

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[All graphs supplied by Legal & General Investment Management]