QUARTERLY REVIEW PREPARED FOR

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OXFORDSHIRE PENSION FUND COMMITTEE – 11 MARCH 2016

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. There have been downward revisions in the forecasts for US and UK GDP growth during the past three months, but it is the long-heralded slowdown in the Chinese economy that has dominated commodities, stock markets and currencies. It has been well known that China wanted to rebalance its economy away from capital investment in infrastructure and towards private consumption, and yet the reality of this policy appears to have taken investors by surprise.

(In the table below, bracketed figures show the forecasts three months ago)

Consensus real growth (%)						**Consumer prices latest (%)**
	2012	**2013**	**2014**	**2015E**	**2016E**	
UK	-0.1	+1.7	+2.8	+2.2 (+2.5)	+2.1	+0.2 (CPI)
USA	+2.2	+1.9	+2.4	+2.4 (+2.4)	+2.3	+0.7
Eurozone	-0.5	-0.4	+0.8	+1.5 (+1.5)	+1.6	+0.4
Japan	+1.9	+1.7	+0.3	+0.6 (+0.7)	+1.1	+0.2
China	+7.8	+7.7	+7.4	+6.9 (+6.9)	+6.4	+1.6

[Source of estimates: The Economist, February 6th, 2016]

2. On December 16th, the Federal Reserve finally raised its interest rate by 0.25% (to a range of 0.25 – 0.5%) but indicated that it expected to make only 'gradual' future increases. This mild language was initially well received by equity markets. The European Central Bank had earlier tightened the penalty interest rate on central bank deposits from -0.2% to -0.3%, and announced that quantitative easing of €600bn per month would be extended from September 2016 to March 2017.

3. The massacre of 130 people in Paris on November 13th by followers of Islamic State caused universal outrage and precipitated the decision by the British parliament to permit UK aircraft to extend their operations to Syria. International tension had already increased when a Russian passenger plane had been shot down shortly after taking off from Egypt in October, to be followed three weeks later by the downing of a Russian fighter jet which had allegedly entered Turkish airspace.

4. In the French regional elections in December, the Front National polled strongly in the first round, but then failed to win any of the 13 regions in the final vote, after a pact between the Socialist and Republican parties. In Spain the ruling People's Party failed to secure an overall majority in parliament after a strong showing by the anti-austerity Podemos and the liberal Ciudadanos parties. The make-up of the new Spanish government is still under discussion.

5. The most striking features of the UK Spending Review in November were the Chancellor's abandonment of plans to cut £4.4bn from tax credits for working people, and the maintenance of the police budget. Extra levies were announced on apprenticeships, on stamp duty for second homes and buy-to-let purchases, as well as a 2% rise in Council Tax if used for additional spending on social care. The Public Sector Borrowing Requirement was forecast to be 3.9% of GDP in 2015-16, but to reach a *surplus* of 0.5% in 2019-20. The Chancellor's forecasts were helped by a £27bn revision in revenue and spending projections over the next five years by the Office for Budget Responsibility.

6. The South African President, Mr Zuma, caused consternation in markets in mid-December by suddenly firing his Finance Minister, Mr Nene, and replacing him with a financially inexperienced MP. Days later the president revoked this appointment and named Pravin Gordhan, who had served previously as Finance Minister. The rand has continued to weaken, nevertheless.

Markets

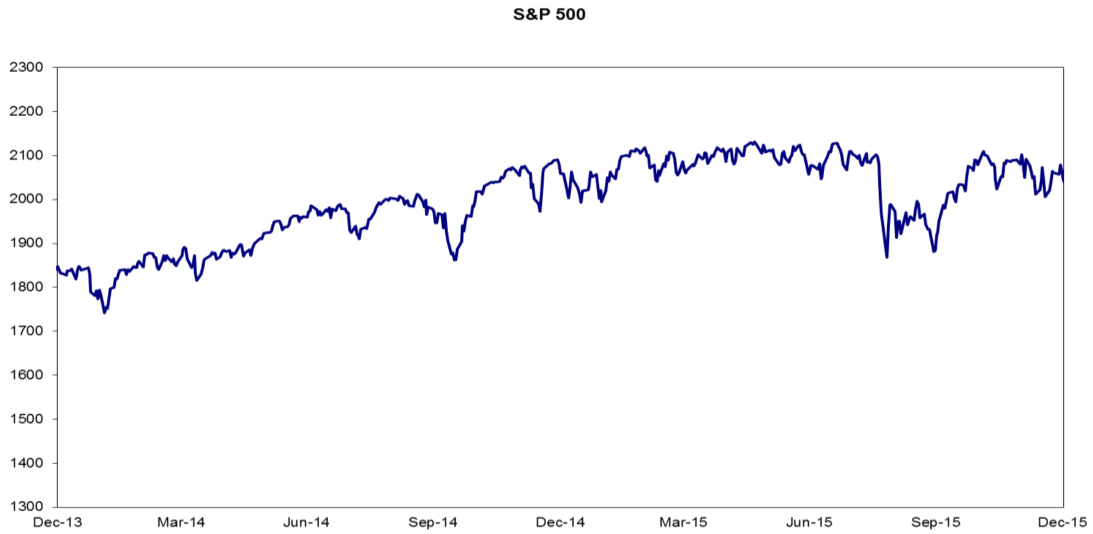
Equities

7. While the All-World Index recouped its third-quarter losses, despite a nervous patch in early December, this was almost entirely attributable to the strength of US equities and the dollar (see graph below). UK, European, Asia-Pacific and Emerging Markets all ended December lower than their end-June levels. For the year 2015, Emerging Markets lagged well behind the Developed Markets, affected variously by lower oil and commodity prices, the slowing of Chinese imports, and currency weakness following the slight depreciation of the Chinese yuan since August.

	Capital return (in £, %) to 31.12.15		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**+7.6**	**+1.5**
54.8	FTSE All-World North America	+8.4	+3.1
8.8	FTSE All-World Japan	+12.3	+15.4
11.2	FTSE All-World Asia Pacific ex Japan	+7.8	-6.4

16.0	FTSE All-World Europe (ex-UK)	+5.6	+2.4
6.9	FTSE All-World UK	+3.0	-4.4
8.1	FTSE All-World Emerging Markets	+2.8	-12.9

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



8. Although all global industrial sectors recorded gains in the quarter, Basic Materials and Oil & Gas remained the laggards as commodity prices continued to fall. Healthcare was buoyed up by actual and prospective merger activity among the major pharmaceutical companies.

Capital return (in £, %) to 31.12.15		
Industry Group	**3 months**	**12 months**
Health Care	+9.9	+11.6
Consumer Services	+7.5	+10.2
Consumer Goods	+9.0	+8.8
Technology	+11.2	+7.1
FTSE All-World	**+7.6**	**+1.5**
Industrials	+8.7	+0.6
Telecommunications	+5.5	-0.2
Financials	+6.4	-1.6

Utilities	+3.1	-6.1
Basic Materials	+5.0	-14.6
Oil & Gas	+1.9	-19.0

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

9. The heavy representation of resource stocks in the FTSE 100 Index ensured that it once more lagged the medium- and small-cap sectors.

(Capital only %, to 31.12.15)	3 months	12 months
FTSE 100	**+ 3.0**	**- 4.9**
FTSE 250	**+ 4.5**	**+8.4**
FTSE Small Cap	**+ 3.4**	**+6.2**
FTSE All-Share	**+ 3.2**	**-2.5**

[Source: Financial Times]

Bonds

10. The prices of government bonds fell, with the result that yields in the major developed markets ended the year slightly above their end-2014 levels. The spreads on corporate bonds relative to government bonds remained much wider than at the start of 2014, driven mainly by the weakness in bonds issued by resource companies.

10-year government bond yields (%)					
	Dec 12	**Dec 13**	**Dec 2014**	**Sept 2015**	**Dec 2015**
US	1.76	3.03	2.17	2.06	2.27
UK	1.85	3.04	1.76	1.77	1.96
Germany	1.32	1.94	0.54	0.59	0.63
Japan	0.79	0.74	0.33	0.35	0.27

[Source: Financial Times]

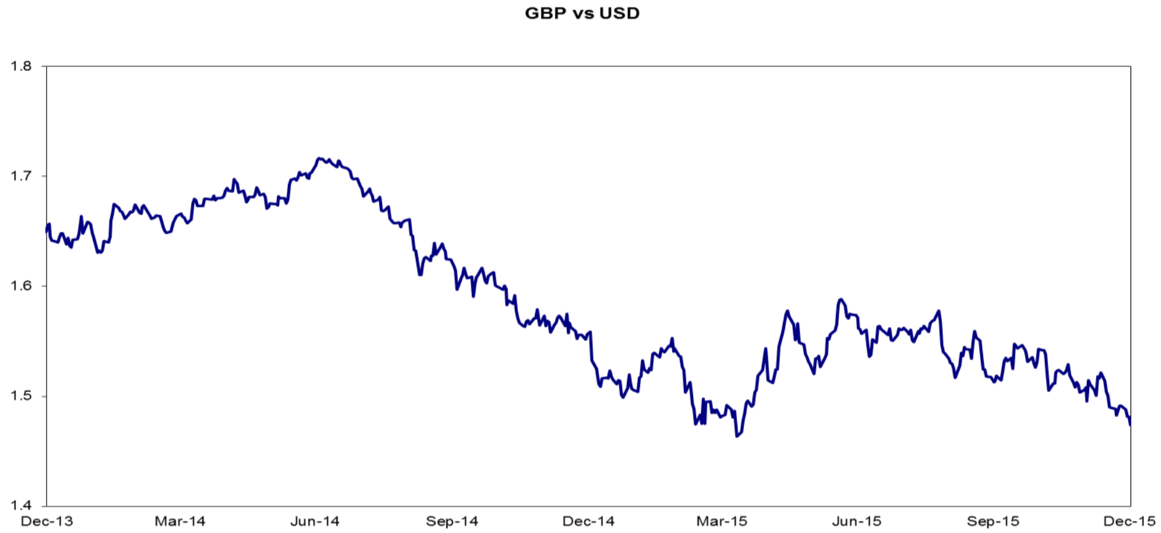
Currencies

11. The US dollar gained ground steadily during the quarter as it became more likely that the Federal Reserve would raise interest rates - an expectation confirmed by the announcement on December 16th.

				£ move (%)	
	31.12.14	**30.9.15**	**31.12.15**	**3m**	**12m**

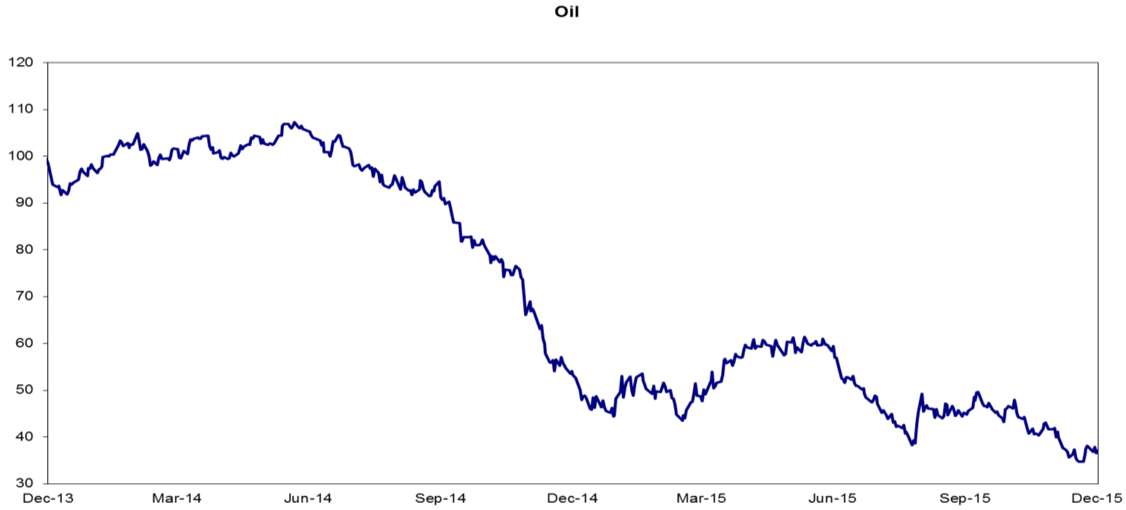
$ per £	1.559	1.515	1.474	-2.7	-5.5
€ per £	1.289	1.357	1.357	unch	+5.3
Y per £	186.9	181.4	177.3	-2.3	-5.1

[Source: Financial Times]

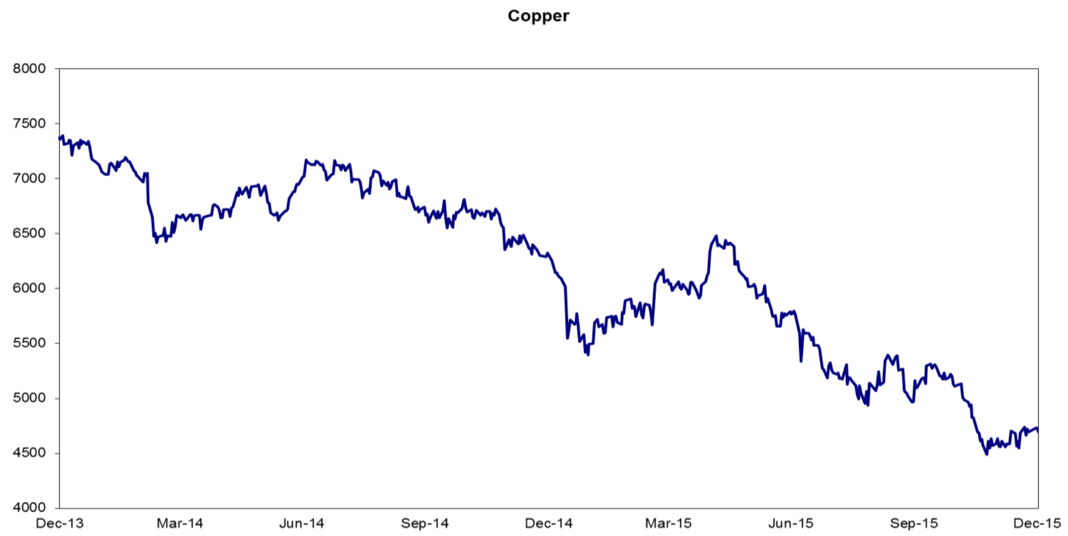


Commodities

12. The price of **oil**, as measured by Brent Crude, fell by over one-fifth from, $48.5 to $37.5, during the quarter as reduced demand was compounded by the failure of the OPEC oil producers to agree on any supply reductions. The slide in the oil price became even steeper in the New Year, and Brent Crude touched $28 in mid-January.



13. The **copper** price also fell, touching a 6-year low in late-November on reduced demand from China, which consumes over 40% of the world's copper output. **Gold** remained stable at around $1100/oz.



Property

14. UK Property continue to give a steady positive return, and although the All-Property Index gain of 13.8% for the year failed to match the 19.3% gain recorded in 2013, the 3-year total return for UK Property stands at an impressive 50%.

	3-month	**12-month**
All Property	**+3.1%**	**+13.8%**
Retail	**+2.3%**	**+ 8.9%**
Office	**+3.6%**	**+18.2%**
Industrial	**+3.8%**	**+17.3%**

[IPD Monthly Index of total returns, December 2015]

Outlook

15. 2016 has opened with a severe bout of nerves in world equity markets. The tone was set in the first week of January, when trading on the Shanghai market was suspended on two days because shares had fallen far enough to trigger the newly-introduced (and hastily abandoned) 'circuit-breakers'. As in August, this raised doubts about the competence of the Chinese authorities, and a small downward shift in the official rate for the yuan/dollar evoked further memories of last summer's problems.

16. Geo-political tension has escalated with the breaking off of diplomatic relations between Saudi Arabia and Iran after the Saudis executed a Shia cleric, and the reported testing of a hydrogen bomb by North Korea on January 6th did little to settle nerves. Sanctions on Iran were lifted after it satisfied that IAEA about the scaling down of its nuclear programme; this raised the prospect of yet more oil being offered on world markets, further depressing the oil price.

17. In the first five weeks of 2016 UK Equities have lost 7%, while the major overseas markets are showing losses (in sterling terms) of 5-8%, with the biggest falls being seen in the Financial sectors. The worries about a global economic slowdown have caused a flight to dollars and 'safe-haven' government bonds. The yen weakened after the Bank of Japan cut the interest payable on excess bank reserves from +0.1% to –0.1% on January 30th. Yields on 10-year US and UK government bonds have fallen by 0.40%, and German and Japanese yields by 0.25%, from their end-2015 levels.

18. The recent jitters in equity markets are similar in cause and scale to the events of the third quarter of 2015, being ignited by worries about slowing growth in China. Estimates of growth in UK and US for 2016 have also been lowered slightly. Even after these reductions, however, global growth in 2016 is not expected to differ much from 2015, and remains well in positive territory. Against this background, I believe that fears of recession are unjustified; I expect equity markets to recover from their current depressed levels, and government bond yields to move back above their end-2015 levels.

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[All graphs supplied by Legal & General Investment Management]