QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

Q1 2016

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OXFORDSHIRE PENSION FUND COMMITTEE – 10 JUNE 2016

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. For the full year 2015, GDP growth slowed in the UK and China relative to 2014, but improved in the Eurozone and Japan. The United States, meanwhile, maintained a 2.4% growth rate. It is noticeable, however, that forecasts for 2016 have been revised down in the past three months – for all regions except China – and growth is expected to be slower than in 2015 everywhere. It is this prospect which has depressed commodity prices and contributed to the sharp falls in equity markets in the opening weeks of 2016.

(In the table below, bracketed figures show the forecasts in my previous report)

Consensus real growth (%)						**Consumer prices latest (%)**
	2013	**2014**	**2015**	**2016E**	**2017E**	
UK	+1.7	+2.8	+2.3	+2.0 (+2.1)	*+2.1*	+0.5(CPI)
USA	+1.9	+2.4	+2.4	+2.0 (+2.3)	*+2.2*	+1.0
Eurozone	-0.4	+0.8	+1.5	+1.4 (+1.6)	*+1.6*	-0.1
Japan	+1.7	+0.3	+0.6	+0.6 (+1.1)	*+0.6*	+0.3
China	+7.7	+7.4	+6.9	+6.5 (+6.4)	*+6.2*	+2.3

[Source of estimates: The Economist, April 9th, 2016]

2. In the UK Budget on March 16th, George Osborne reduced his forecasts for GDP growth from 2.4% to 2.0% for 2016, and from 2.5% to 2.2% for 2017. The budget deficit will fall to 3.8% of GDP in the 2015/16 tax year, and is forecast to reduce thereafter by around 1% annually, before moving into surplus – on some ambitious spending assumptions – in the 2019/20 year. The Chancellor's target of cutting public sector debt as a proportion of GDP each year will be missed in 2015/16, when the ratio rises from 83.3% to 83.7%.

3. The proposed introduction of a ‘sugar tax’ on certain soft drinks was eclipsed from the headlines two days later when Iain Duncan Smith resigned as Work and Pensions Secretary after disagreements with the Chancellor over cuts to disability benefits.

4. In attempts to stimulate their flagging economy, the Bank of Japan introduced a negative interest rate of 0.1% on excess bank reserves at the end of January, and in March the European Central Bank cut its main interest rate to zero. Meanwhile the Federal Reserve, having raised rates by 0.25% in December, has made no further increase, and is expected to make only two rises in 2016 instead of the four previously indicated.

5. The announcement in February that the UK Referendum on EU membership would take place on June 23rd heralded the start of a debate which cuts across political party lines. With Government ministers being permitted to campaign against the official Government policy of remaining in the EU, attention has also been focused on the splits within the Conservative party and the possibility of a change of leadership after the Referendum.

Markets

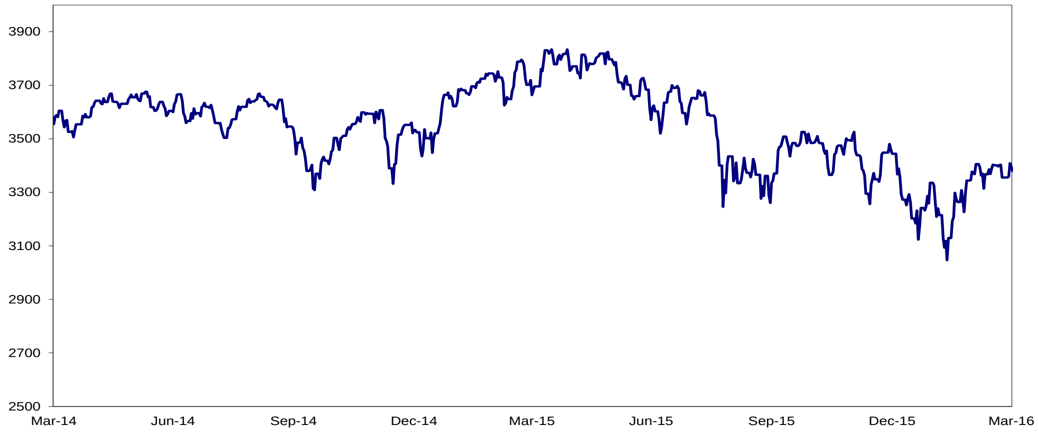
Equities

6. After falling by 10% or more in the first six weeks of the quarter, on fears of global economic slowdown and geo-political worries, equity markets then recovered sharply and - with the exception of Japan – recouped all the lost ground. The weakness of sterling enhanced the performance of overseas markets in sterling terms, as shown in the table below. In February the UK market touched its lowest level for 3 ½ years.

	Capital return (in £, %) to 31.3.16		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**+2.3**	**-3.0**
55.2	FTSE All-World North America	+3.6	+1.4
8.2	FTSE All-World Japan	-5.2	-5.3
11.5	FTSE All-World Asia Pacific ex Japan	+4.1	-10.6
15.9	FTSE All-World Europe (ex-UK)	+0.3	-6.7
6.7	FTSE All-World UK	-0.9	-8.4
8.7	FTSE All-World Emerging Markets	+8.4	-11.5

[Source: FTSE All-World Review, March 2016]

UK FTSE All-Share



7. In contrast to the recent pattern, resource stocks were among the strongest sectors during the quarter. After the gloom of the early weeks, the improved sentiment caused a complete reversal, aided by short-covering by investors, and Basic Materials and Oil & Gas each rose by 7.7% in sterling terms. The weakness of the Financials sector was largely due to falls in Banks and Life Insurance on fears about bad debts and the effects of negative interest rates on profits.

Capital return (in £, %) to 31.3.16		
Industry Group	**3 months**	**12 months**
Technology	+4.6	+5.1
Utilities	+11.1	+4.9
Consumer Goods	+3.8	+3.7
Consumer Services	+3.4	+3.6
Telecommunications	+9.1	+2.3
Industrials	+5.1	-1.9
FTSE All-World	**+2.3**	**-3.0**
Health Care	-4.5	-5.4
Financials	-3.1	-9.4
Basic Materials	+7.7	-13.3
Oil & Gas	+7.7	-13.7

[Source: FTSE All-World Review, March 2016]

8. In the UK, the large-cap FTSE 100 out-performed the mid- and small-cap sectors, for the first time in over a year.

(Capital only %, to 31.3.16)	3 months	12 months
FTSE 100	-1.1	-8.8
FTSE 250	-2.9	-1.0
FTSE Small Cap	-2.0	-1.2
FTSE All-Share	-1.4	-7.3

[Source: Financial Times]

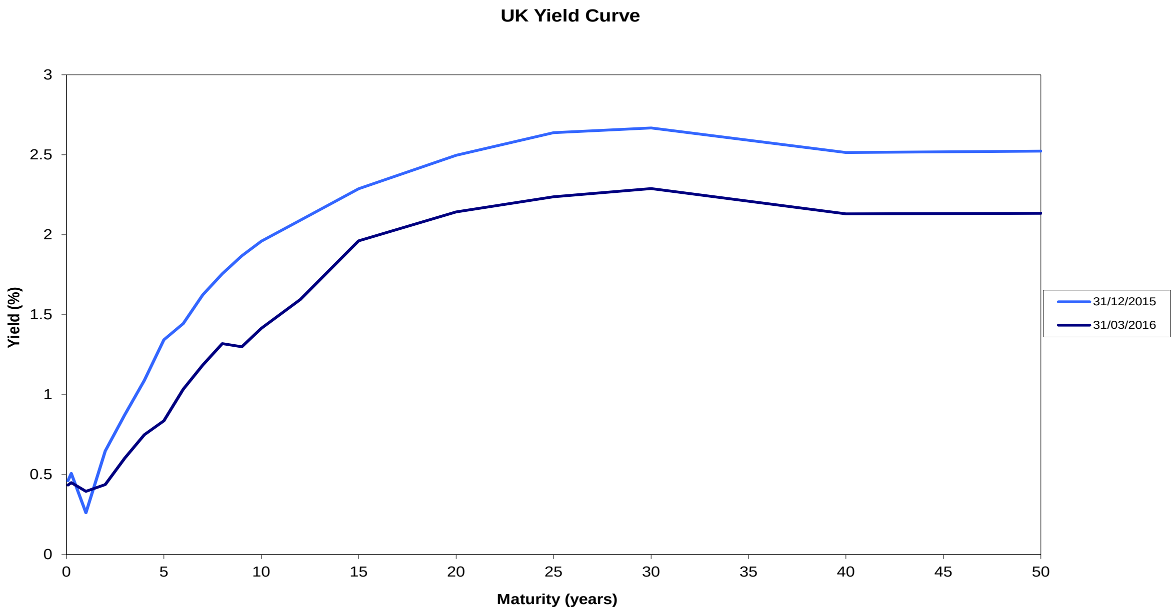
Bonds

9. Against a background of slowing growth and muted inflation, government bonds strengthened noticeably in the quarter. In Japan, 10-year yields turned negative, while German bond yields moved close to zero. Corporate bond spreads widened until mid-February, but then narrowed in overseas markets; UK spreads remained wider because of nervousness about the EU Referendum.

10-year government bond yields (%)					
	Dec 13	Dec 2014	Sept 2015	Dec 2015	Mar 2016
US	3.03	2.17	2.06	2.27	1.81
UK	3.04	1.76	1.77	1.96	1.54
Germany	1.94	0.54	0.59	0.63	0.15
Japan	0.74	0.33	0.35	0.27	-0.05

[Source: Financial Times]

UK bond yields fell significantly at all durations longer than 3 months.



Currencies

10. Sterling weakened after the announcement of the EU Referendum, falling at one stage below $1.40, but the big surprise was the strength of the euro and the yen despite central banks in both regions introducing negative interest rates.

				£ move (%)	
	31.3.15	**31.12.15**	**31.3.16**	**3m**	**12m**
$ per £	1.485	1.474	1.437	-2.5	-3.2
€ per £	1.382	1.357	1.261	-7.1	-8.8
Y per £	178.0	177.3	161.5	-9.3	-8.9

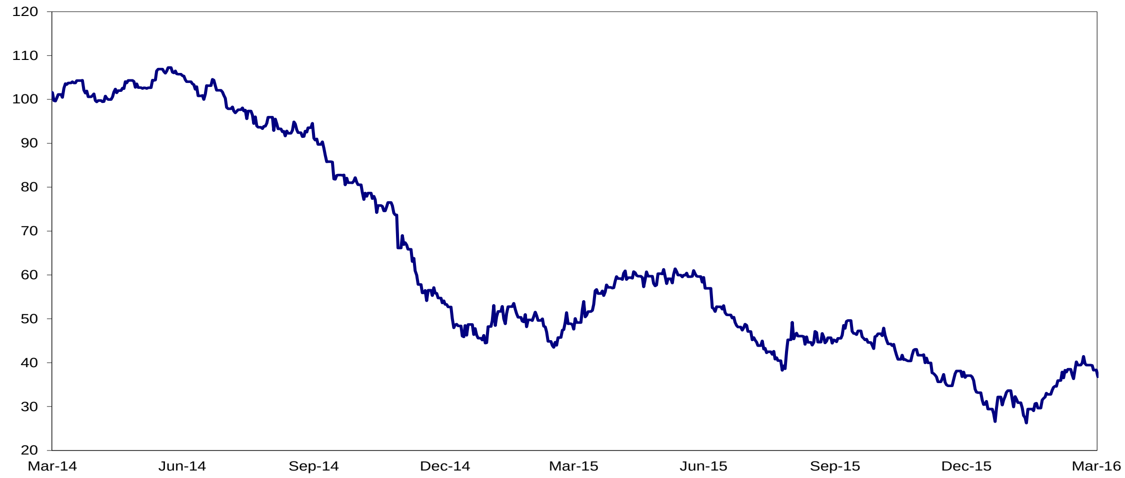
[Source: Financial Times]

GBP vs EUR

Commodities

11. Oil continued its steep decline, with Brent crude falling as low as $28 per barrel in February, before it recovered to move above $40 at the end of the quarter. Copper firmed slightly, while gold gained no less than 16%.

Oil



Property

12. **UK Property** returns in the quarter were reliant on rental income, as capital growth has tapered off after three strong years. The forthcoming EU Referendum appears to have discouraged foreign buyers from investing in Central London property until the outcome of the vote is known, and investors appear to be net sellers of pooled property funds.

	3-month	12-month
All Property	**+1.1%**	**+11.7%**
Retail	**+0.6%**	**+ 7.5%**
Office	**+1.3%**	**+15.2%**
Industrial	**+1.5%**	**+15.0%**

[IPD Monthly Index of total returns, March 2016]

Outlook

13. Equity markets have been moving in response to movements in the price of oil – falling sharply as oil declined to below $30 in February, but recovering strongly as oil rose above $40 in March. The recent OPEC meeting failed to reach agreement on limiting oil production, which may prevent the oil price from exceeding $50 in the near term.

14. Geo-political worries continue to cast a shadow: the Syrian conflict, where the ceasefire appears to be breaking down, the migrant crisis in Europe, and the threat of terrorism as exemplified by the attacks in Brussels on March 22nd. With the EU Referendum taking place in the UK on June 23rd, and the US Presidential Election due in November, there are numerous uncertainties for investors to wrestle with.

15. Against this background, and with global growth slowing, the possibility of significant gains in equities during the remainder of 2016 looks slim, whereas government bonds are likely to be in demand as safe havens in uncertain times.

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[All graphs supplied by Legal & General Investment Management]