QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

Q3 2016

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OXFORDSHIRE PENSION FUND COMMITTEE – 2 DECEMBER 2016

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. UK base rate was cut to 0.25%, and quantitative easing resumed, on August 4th. UK GDP growth of 0.5% for the 3rd quarter was better than expected, and only slightly below the 2nd quarter rate of 0.7%. The US Federal Reserve has continued to delay raising interest rates, but the September decision was not unanimous, and there were hints that a rise in December was likely. (No change in rates is expected before the US Presidential Election on November 8th).

(In the table below, bracketed figures show the forecasts made in August)
[Source of estimates: The Economist, October 8th, 2016]

Consensus real growth (%)						Consumer prices latest (%)
	2013	**2014**	**2015**	**2016E**	**2017E**	
UK	+1.7	+2.8	+2.3	+1.8 (+1.6)	+ 0.7	+1.0(CPI)
USA	+1.9	+2.4	+2.4	+1.5 (+1.7)	+ 2.1	+1.5
Eurozone	-0.4	+0.8	+1.5	+1.5 (+1.5)	+1.3	+0.4
Japan	+1.7	+0.3	+0.6	+0.6 (+0.5)	+ 0.9	-0.5
China	+7.7	+7.4	+6.9	+6.6 (+6.5)	+6.3	+1.9

2. The value of the pound has continued to fall, reaching $1.30 at the end of September, but then sliding to $1.22 in mid-October on signs from the Conservative Party Conference that the government was planning to implement a 'Hard Brexit' policy.

3. The Bank of Japan has altered its method of quantitative easing (QE); its policy now is to maintain a 0% yield on the 10-year Japan Government Bond, and to target an inflation rate of 2%.

Markets

<u>Equities</u>

4. **UK equities** had a strong quarter after the Bank of England's cut in interest rates and the resumption of QE, while overseas markets (notably the Pacific Rim) also gained ground, with the weakness of sterling (see para 8) amplifying these gains in £ terms.

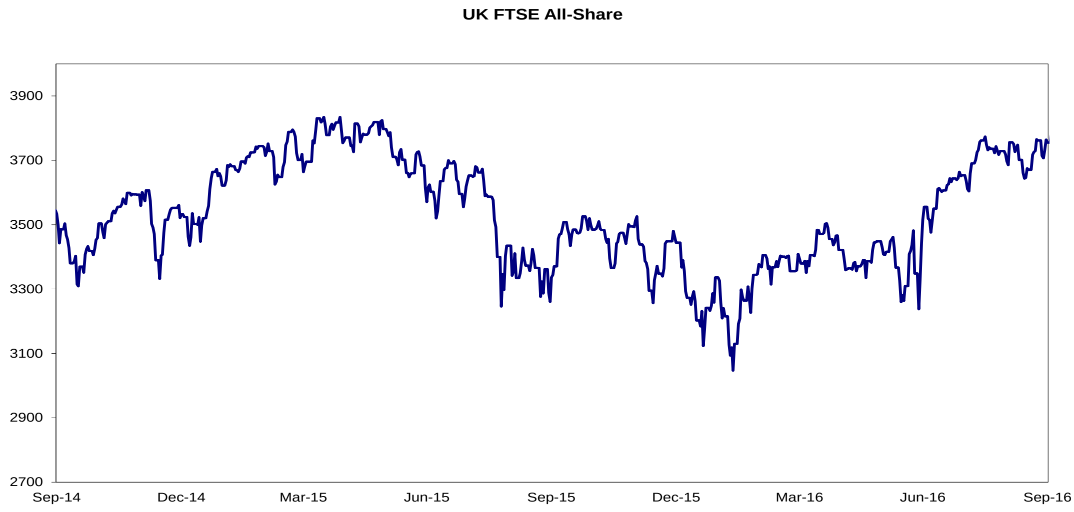
	Capital return (in £, %) to 30.9.16		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**+ 7.8**	**+27.9**
55.0	FTSE All-World North America	+ 6.5	+31.2
8.5	FTSE All-World Japan	+11.1	+28.4
11.9	FTSE All-World Asia Pacific ex Japan	+11.3	+33.9
15.3	FTSE All-World Europe (ex-UK)	+ 8.7	+17.6
6.5	FTSE All-World UK	+ 6.3	+13.9
9.1	FTSE All-World Emerging Markets	+10.2	+32.6

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

5. The recent outperformance of the FTSE 100 Index relative to mid- and small-cap indices failed to persist in the quarter, although the 12-month returns are still showing superior performance from the large-caps.

(Capital only %, to 30.9.16)	**3 months**	**12 months**
FTSE 100	**+ 6.1**	**+13.8**
FTSE 250	**+ 9.8**	**+ 7.1**
FTSE Small Cap	**+11.3**	**+11.0**
FTSE All-Share	**+ 6.8**	**+12.6**

[Source: Financial Times]



6. Sectorally there has been an enormous change in relative performance during 2016. In the year 2015, Basic Materials and Oil & Gas were by far the weakest sectors, as a result of the falls in oil and raw material prices, while the more stable Health Care and Consumer Services sectors out-performed them by some 30-35% during the year. In 2016, by contrast, the recovery in commodity prices has caused gains of some 30% in Basic Materials and Oil & Gas in the first 9 months of the year, against 10-15% gains for Health Care and Consumer Services.

Capital return (in £, %) to 30.9.16		
Industry Group	**3 months**	**12 months**
Technology	+16.3	+41.1
Basic Materials	+12.4	+37.7
Industrials	+ 9.5	+34.8
Oil & Gas	+ 4.3	+33.3
Consumer Goods	+ 6.1	+29.6
FTSE All-World	**+ 7.8**	**+27.9**
Utilities	-0.6	+26.5
Telecommunications	+ 0.4	+25.8
Consumer Services	+ 6.1	+24.3
Health Care	+ 2.7	+22.3
Financials	+10.1	+18.5

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

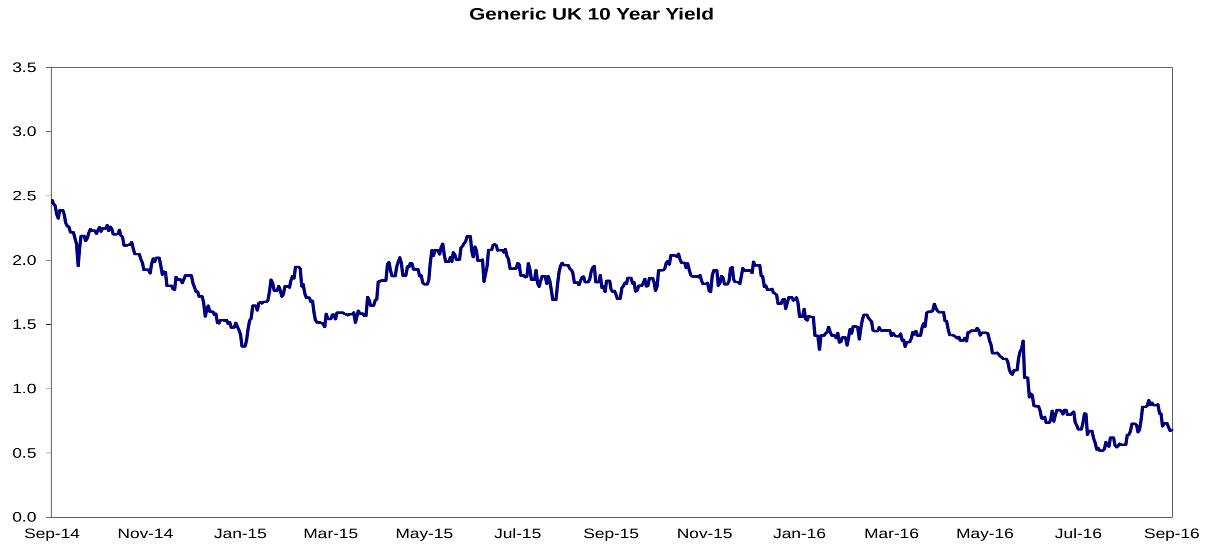
Bonds

7. **Gilts** were the only one of the major government bond markets to record significant falls in yield during the quarter, but the yield then rebounded to 1.15% by mid-October after the Governor of the Bank of England said that the Bank would tolerate higher UK inflation, possibly above the 2% target level.

10-year government bond yields (%)					
	Dec 13	**Dec 2014**	**Dec 2015**	**June 2016**	**Sept 2016**
US	3.03	2.17	2.27	1.46	1.59
UK	3.04	1.76	1.96	1.00	0.75

Germany	1.94	0.54	0.63	-0.13	-0.19
Japan	0.74	0.33	0.27	-0.23	-0.08

[Source: Financial Times]

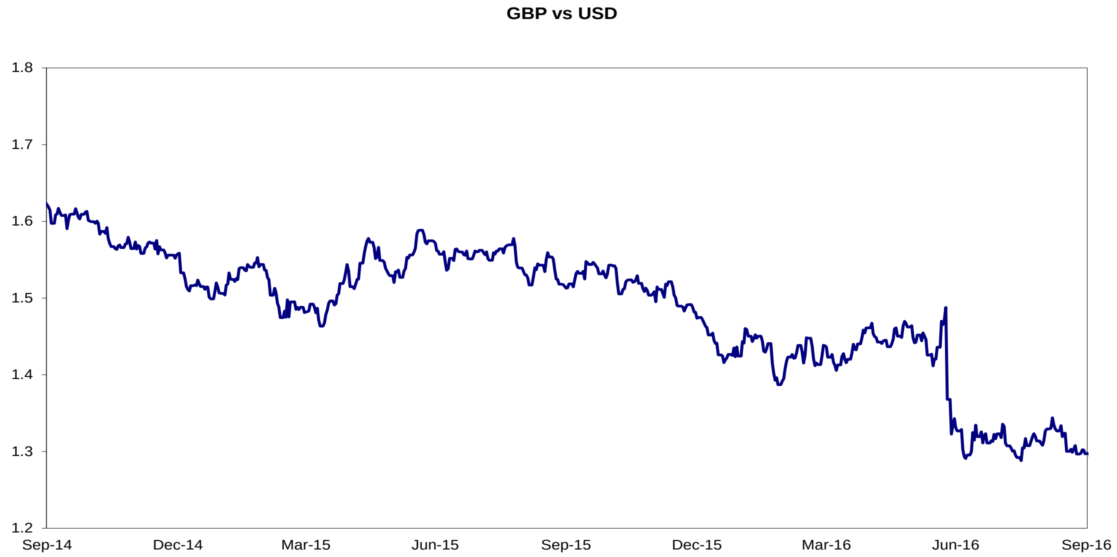


Currencies

8. After its sharp fall following the Brexit vote, the pound traded close to the $1.30 level during the quarter, but weakened to as low as $1.22 in mid-October following the rhetoric at the Conservative Party Conference.

				£ move (%)	
	30.9.15	**30.6.16**	**30.9.16**	**3m**	**12m**
$ per £	1.515	1.337	1.299	-2.8	-14.3
€ per £	1.357	1.203	1.156	-3.9	-14.8
Y per £	181.4	137.1	131.5	-4.1	-27.5

[Source: Financial Times]



Commodities

9. Oil, as measured by Brent Crude, traded in the $45-50 range during the quarter, strengthening at the end of September when it appeared that the OPEC producers had reached agreement to limit oil output to 32.5m barrels/day, although the details of how this will be implemented remain unclear. Gold moved in a narrow range, showing weakness when there were expectations of a rise in US interest rates, but recovering when the Fed deferred any rise.

Property

10. Capital values of UK commercial property fell in the third quarter, amid the fallout from the Brexit vote. The level of redemption requests from retail investors, combined with uncertainty over the future demand for office space in London, has made valuation more difficult than usual.

	3-month	**12-month**
All Property	**- 2.3%**	**+ 3.2%**
Retail	**- 2.4%**	**+ 1.5%**
Office	**- 3.5%**	**+ 2.5%**
Industrial	**- 0.7%**	**+ 6.6%**

[IPD Monthly Index of total returns, September 2016]

Outlook

11. Equity and bond markets continued to be buoyed up by the maintenance of low rates of interest globally, and by quantitative easing programmes in UK, the Eurozone and Japan. The Federal Reserve may well raise the US interest rate in December, but this would be the only rise this year – a far cry from the four rate rises predicted for 2016. Despite this monetary backdrop, global economic growth for 2016 will still be slower than the previous year, and 2017 may see a further slowdown.

12. The UK's decision to leave the EU has caused a 15% fall in sterling, which is likely to produce higher inflation as the cost of imported goods rises, and the translation effect hits the price of petrol. The September CPI rose to +1.0% annually, even before the effects of the weaker pound. If real wage growth again turns negative, consumer spending will be dampened, while the outlook for UK employment may well worsen if capital spending decisions are delayed. The UK government's fiscal stance will be set out by the Chancellor in his Autumn Statement on November 23rd.

13. It would be unwise to forecast the result of the US Presidential Election on November 8th; the markets, however, would face a period of extreme uncertainty if Donald Trump were to win, given his declared opposition to free trade and his isolationist rhetoric. With all these uncertainties, and with the crisis in Syria continuing, it remains hard to see equity or bond markets appreciating further from current levels.

Peter Davies
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October 28th, 2016

[All graphs supplied by Legal & General Investment Management]