



QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

Q2 2017

11<sup>th</sup> August 2017

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**PENSION FUND COMMITTEE – 15 SEPTEMBER 2017**

**OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS**

**Report by the Independent Financial Adviser**

**Economy**

1. The UK economy continued to grow at a quarterly rate of just 0.3% in the second quarter, and the Bank of England revised its estimate for 2017 downwards from 1.9% to 1.7%. US employment data have been stronger than expected, while China announced GDP growth at an annual rate of 6.9% for the second quarter. The Federal Reserve raised US interest rates by 0.25% to the 1 – 1.25% range in June, and is generally expected to raise once more during 2017.

(In the table below, bracketed figures show the forecasts made in May)

| <b>Consensus real growth (%)</b> |             |             |             |              |              | <b>Consumer prices latest (%)</b> |
|----------------------------------|-------------|-------------|-------------|--------------|--------------|-----------------------------------|
|                                  | <b>2014</b> | <b>2015</b> | <b>2016</b> | <b>2017E</b> | <b>2018E</b> |                                   |
| <b>UK</b>                        | +2.8        | +2.3        | +2.0        | +1.6 (+1.6)  | +1.2         | +2.6(CPI)                         |
| <b>USA</b>                       | +2.4        | +2.4        | +1.6        | +2.2 (+2.2)  | +2.3         | + 1.9                             |
| <b>Eurozone</b>                  | +0.8        | +1.5        | +1.6        | +1.9 (+1.7)  | +1.7         | + 1.3                             |
| <b>Japan</b>                     | +0.3        | +0.6        | +0.9        | +1.3 (+1.3)  | +1.1         | + 0.4                             |
| <b>China</b>                     | +7.4        | +6.9        | +6.7        | +6.7 (+6.6)  | +6.3         | + 1.5                             |

[Source of estimates: The Economist, July 8<sup>th</sup>, 2017]

2. In the UK General Election on June 8<sup>th</sup> the Conservatives lost their overall majority, and entered into a pact with the DUP to ensure they had a working majority in Parliament. Negotiations opened on the terms of Britain's exit from the EU. Terrorist attacks in Manchester and London caused profound shock, as did the disastrous fire at Grenfell Tower in West London.
3. In France, Emmanuel Macron convincingly secured the presidency, and his newly-formed political party then won a resounding majority in the National Assembly. This result was welcomed within the Eurozone, although the new president may not find it easy to implement his economic programme.

4. US political developments continue at breakneck pace; President Trump sacked the FBI director in May, but shortly afterwards the Assistant Attorney-General appointed Robert Mueller as special investigator into possible Russian involvement in the 2016 election campaign. The President has withdrawn the US from the Paris Climate Accord and endorsed the Gulf states' boycott of Qatar. Meanwhile tension has been building up after North Korea's test missile launches, with the United Nations voting to impose sanctions on North Korea's exports.

## Markets

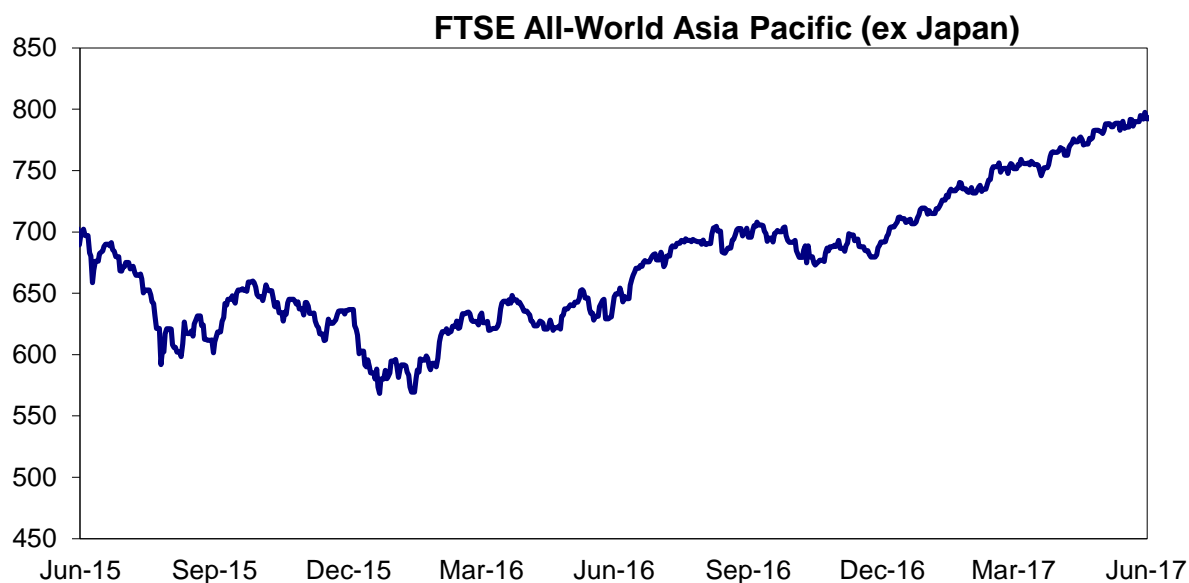
### Equities

5. Equity markets were little changed on balance during the quarter, with UK and US indices remaining close to their all-time high levels.

|                 | <b>Capital return (in £, %) to 30.6.17</b> |                 |                  |
|-----------------|--|-----------------|------------------|
| <b>Weight %</b> | Region                                     | <b>3 months</b> | <b>12 months</b> |
| <b>100.0</b>    | FTSE All-World Index                       | <b>- 0.3</b>    | <b>+19.9</b>     |
| 54.8            | FTSE All-World North America               | -1.4            | +18.8            |
| 8.4             | FTSE All-World Japan                       | +1.4            | +21.4            |
| 12.0            | FTSE All-World Asia Pacific ex Japan       | +0.4            | +24.1            |
| 15.0            | FTSE All-World Europe (ex-UK)              | +2.7            | +24.8            |
| 6.1             | FTSE All-World UK                          | -0.3            | +12.5            |
| 9.2             | FTSE All-World Emerging Markets            | -0.8            | +20.7            |

[Source: FTSE All-World Review, June 2017]

6. Pacific Basin equities have risen steadily over the past eighteen months (see graph).



7. Among the sectors of the equity market, Oil & Gas and Telecommunications were significantly weak in the quarter, while Technology has become the leading sector over one year, spurred on by the strength of the 'FAANGs' (Facebook, Apple, Amazon, Netflix and Google).

|                 | <b>Capital return (in £, %) to 30.6.17</b> |                 |                  |
|-----------------|--|-----------------|------------------|
| <b>Weight %</b> | <b>Industry Group</b>                      | <b>3 months</b> | <b>12 months</b> |
| 12.6            | Technology                                 | +0.7            | +36.4            |
| 22.8            | Financials                                 | +0.2            | +30.4            |
| 4.7             | Basic Materials                            | -2.7            | +27.3            |
| 12.9            | Industrials                                | +1.5            | +25.3            |
| <b>100.0</b>    | <b>FTSE All-World</b>                      | <b>-0.3</b>     | <b>+19.9</b>     |
| 10.4            | Consumer Services                          | -0.9            | +15.6            |
| 13.4            | Consumer Goods                             | +1.0            | +15.3            |
| 10.7            | Health Care                                | +2.6            | +10.8            |
| 3.3             | Utilities                                  | -1.3            | +4.1             |
| 6.0             | Oil & Gas                                  | -9.1            | +0.7             |
| 3.2             | Telecommunications                         | -5.3            | -2.6             |

[Source: FTSE All-World Review, June 2017]

8. In the UK market, the medium and small-cap sectors have resumed their leadership relative to the FTSE 100 segment.

| (Capital only%, to 30.6.17) | 3 months    | 12 months    |
|-----------------------------|-------------|--------------|
| <b>FTSE 100</b>             | <b>-0.1</b> | <b>+12.4</b> |
| <b>FTSE 250</b>             | <b>+1.9</b> | <b>+18.9</b> |
| <b>FTSE Small Cap</b>       | <b>+2.8</b> | <b>+24.9</b> |
| <b>FTSE All-Share</b>       | <b>+0.3</b> | <b>+13.8</b> |

[Source: Financial Times]

### Bonds

9. The main **Government bond** yields were little changed during the quarter, although the yield gap between US Treasuries and UK gilts narrowed by ¼%.

| 10-year government bond yields (%) |         |          |          |          |           |
|------------------------------------|---------|----------|----------|----------|-----------|
|                                    | Dec '14 | Dec 2015 | Dec 2016 | Mar 2017 | June 2017 |
| <b>US</b>                          | 2.17    | 2.27     | 2.46     | 2.41     | 2.28      |
| <b>UK</b>                          | 1.76    | 1.96     | 1.24     | 1.22     | 1.33      |
| <b>Germany</b>                     | 0.54    | 0.63     | 0.11     | 0.33     | 0.47      |
| <b>Japan</b>                       | 0.33    | 0.27     | 0.04     | 0.07     | 0.09      |

[Source: Financial Times]

### **Currencies**

10. The dollar has continued to weaken, despite the rises in US interest rates. Its trade-weighted index against other world currencies fell 7% in the first seven months of 2017. In the same period, the euro index gained 6%, as the Eurozone economies delivered stronger growth than expected. The euro's recent strength against the pound is shown in the graph below.

|          |         |         |         | £ move (%) |      |
|----------|---------|---------|---------|------------|------|
|          | 30.6.16 | 31.3.17 | 30.6.17 | 3m         | 12m  |
| \$ per £ | 1.337   | 1.251   | 1.299   | +3.8       | -2.8 |
| € per £  | 1.203   | 1.189   | 1.139   | -4.2       | -5.3 |
| ¥ per £  | 137.1   | 139.3   | 146.0   | +4.8       | +6.5 |

[Source: Financial Times]

### GBP vs EUR



### Commodities

11. The Oil price has remained in the \$45-55 range, fluctuating as estimates of production and reserves are revised. In July the price of Copper reached its highest level since May 2015, spurred on by increased demand from China.

### Copper



## Property

12. In UK Property, the Industrial sector continues to provide the strongest returns, while the quarterly returns on Retail and Office derive almost entirely from rental income. The 12-month figures have improved since March because the post-Brexit referendum weakness of June 2016 has dropped out of the 12-month comparison.

|                     | 3-month (%)  | 12-month     |
|---------------------|--------------|--------------|
| <b>All Property</b> | <b>+ 2.5</b> | <b>+ 5.1</b> |
| <b>Retail</b>       | <b>+ 1.8</b> | <b>+ 3.0</b> |
| <b>Office</b>       | <b>+ 1.9</b> | <b>+ 2.2</b> |
| <b>Industrial</b>   | <b>+ 4.6</b> | <b>+12.4</b> |

[IPD Monthly Index of total returns, June 2017]

## Outlook

13. Having disregarded geo-political risks for a long period, equity markets are beginning to worry about the standoff with North Korea and the unpredictable nature of any response from the US under President Trump. Meanwhile, the failure of his administration to get healthcare legislation through Congress has cast doubt on the likelihood of passing tax reform and infrastructure packages on which so many hopes rested. The turnover among senior White House staff, and the ongoing investigation into links with Russia, add to the uncertainty surrounding the direction of US policy on the major issues of the day.
14. After the UK election resulted in a hung parliament, and a severe weakening of the Prime Minister's authority, the equity market and sterling have reacted calmly, but the effect on domestic consumption of negative real wage growth seems likely to further depress UK economic growth. The progress of Brexit negotiations with the EU will become an increasing influence on sentiment in markets and in the country at large, so the near-term outlook is highly uncertain.
15. Against this background, it is hard to see equity markets moving into new high ground, while the 'safe-haven' government bond markets may well attract investors and thereby keep yields in those markets at current levels.

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**August 11<sup>th</sup>, 2017**

[All graphs supplied by Legal & General Investment Management]