# Oxfordshire Council Pension Fund

Quarterly Review Q1 2018

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Peter Davies – independent financial adviser

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# PENSION FUND COMMITTEE – 8 JUNE 2018

# OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

## Report by the Independent Financial Adviser

### Economy

1. While all regions are expecting good growth in 2018, forecasts have moderated slightly since January, with falls in industrial production reported in the Eurozone, weaker than expected employment growth in the US and signs of softening in China. (In the table below the bracketed figures show the forecasts made in January)

| **Consensus real growth (%)** | | | | | | **Consumer prices latest (%)** |
|---|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **2018E** | **2019E** | |
| **UK** | +2.3 | +2.0 | +1.6 | +1.5 (+1.4) | +1.5 | +2.5(CPI) |
| **USA** | +2.4 | +1.6 | +2.3 | +2.8 (+2.6) | +2.5 | + 2.4 |
| **Eurozone** | +1.5 | +1.6 | +2.3 | +2.4 (+2.3) | +2.1 | + 1.4 |
| **Japan** | +0.6 | +0.9 | +1.7 | +1.5 (+1.5) | +1.2 | + 1.5 |
| **China** | +6.9 | +6.7 | +6.8 | +6.6 (+6.5) | +6.4 | + 2.1 |

[Source of estimates: The Economist, April 14th 2018]

2. In March the Federal Reserve raised US interest rates by a further 0.25%, to the 1.5 – 1.75% range. Two of the nine members of the UK Monetary Policy Committee voted for a rate rise in March, but the recent slowing of the UK economy has made such a rise less likely in the near term. The UK Financial Statement in March included an improved level of public borrowing in the current tax year, and hinted at public spending increases in the Autumn Budget.

3. President Trump's pronouncements have continued to make headlines. After announcing planned tariffs on imported steel and aluminium (later modified to exclude several nations), he then proposed tariffs on certain Chinese imports, to which the Chinese government responded with its own list of US imports to be penalised. On May 8th the President announced the US withdrawal from the Iran nuclear deal, and he is due to meet the President of North Korea.

4. After the poisoning of a former Russian agent and his daughter in Salisbury on March 3rd, many countries emulated the British government's action in expelling Russian diplomats from their embassies. In April US, French and UK forces launched co-ordinated air attacks on Syrian chemical weapons bases after the Syrian government had been accused of using such weapons against the inhabitants of Douma.

5. In Germany, members of the opposition SDP voted in favour of the renewal of a coalition with the CDU/CSU, allowing Chancellor Merkel to remain in office, while the shape of the Italian government remains uncertain after the General Election of March

4th produced big gains for the Five Star Movement. In South Africa Cyril Ramaphosa replaced Jacob Zuma as President.

**Markets**

Equities

6. Overseas equity markets started the year very strongly - US markets had risen 7% by January 26th – but the release of a US hourly wages figure of +2.9% ignited fears of higher inflation, and within two weeks most markets had fallen by 10%. After sharp swings in February and March, they ended the quarter close to their early- February lows. The performance of the UK equity market continues to lag behind all overseas regions, while the 5% fall in the All-World Index made this the worst quarter for global equities since Q3 2015.

| | **Capital return (in £, %) to 31.3.18** | | |
|---|---|---|---|
| **Weight %** | Region | **3 months** | **12 months** |
| **100.0** | FTSE All-World Index | **- 5.0** | **+ 0.4** |
| 54.0 | FTSE All-World North America | -5.0 | - 0.7 |
| 8.7 | FTSE All-World Japan | -3.5 | + 5.3 |
| 12.9 | FTSE All-World Asia Pacific ex Japan | -4.8 | + 2.9 |
| 15.8 | FTSE All-World Europe (ex-UK) | - 4.9 | + 1.4 |
| 5.9 | FTSE All-World UK | - 8.2 | - 3.9 |
| 10.5 | FTSE All-World Emerging Markets | - 2.5 | + 5.7 |

[Source: FTSE All-World Review, March 2018]

7. Technology was the most resilient sector during the quarter, and for the year, although it has recently been hit by the revelations of the disclosure of personal details of Facebook users.

| | **Capital return (in £, %) to 31.3.18** | | |
|---|---|---|---|
| **Weight %** | **Industry Group** | **3 months** | **12 months** |
| 14.1 | Technology | -1.0 | +12.3 |
| 13.1 | Industrials | -5.0 | +2.7 |
| 4.6 | Basic Materials | -7.8 | +2.1 |
| 22.7 | Financials | -4.9 | +1.3 |
| 10.8 | Consumer Services | -3.3 | +0.7 |
| **100.0** | **FTSE All-World** | **-5.0** | **+0.4** |
| 10.2 | Health Care | -4.9 | -2.8 |

| | | | |
|---|---|---|---|
| 12.6 | Consumer Goods | -6.8 | -3.0 |
| 6.1 | Oil & Gas | -7.8 | -7.3 |
| 3.0 | Utilities | -5.6 | -8.2 |
| 2.8 | Telecommunications | -9.4 | -14.8 |

[Source: FTSE All-World Review, March 2018]

8. UK shares started the year on a weak note, because of sterling's strength and Brexit uncertainties, and fell further during the period of heightened volatility in February and March. The mid- and small-cap sections of the market again out-performed the large-caps.

| (Capital only%, to 31.3.18) | 3 months | 12 months |
|---|---|---|
| **FTSE 100** | **- 8.2** | **-2.8** |
| **FTSE 250** | **- 6.1** | **+2.6** |
| **FTSE Small Cap** | **-5.4** | **+3.0** |
| **FTSE All-Share** | **-7.8** | **-2.4** |

[Source: Financial Times]

9. The All-Share Index ended the quarter 9% below the high it had reached in December.

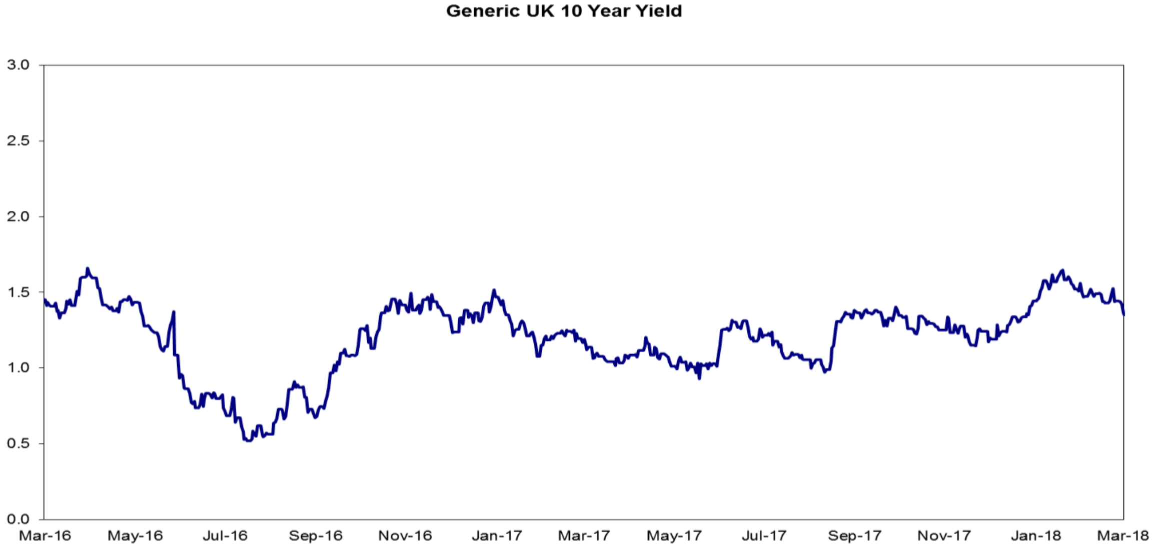

Bonds

10. The yield on US Treasuries rose again during the quarter, as economic data showed rising levels of wage growth and the Fed Funds rate was increased. Elsewhere there was little change in the main sovereign bond yields.

| 10-year government bond yields (%) | | | | | |
|---|---|---|---|---|---|
| | **Dec '14** | **Dec 2015** | **Dec 2016** | **Dec 2017** | **Mar 2018** |
| **US** | 2.17 | 2.27 | 2.46 | 2.43 | 2.75 |
| **UK** | 1.76 | 1.96 | 1.24 | 1.23 | 1.35 |
| **Germany** | 0.54 | 0.63 | 0.11 | 0.43 | 0.50 |
| **Japan** | 0.33 | 0.27 | 0.04 | 0.05 | 0.04 |

[Source: Financial Times]

11. The 10-year Gilt yield remains below 1.5%

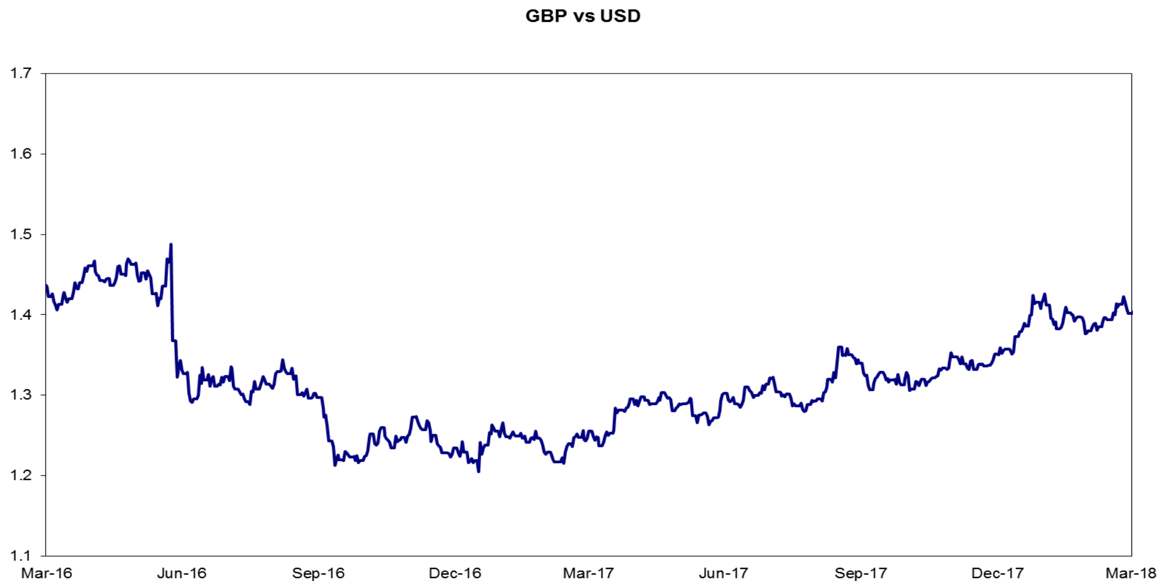



**Currencies**

12. Sterling strengthened against the dollar and, to a lesser, extent, the euro, but gave back some of its recent gains against the yen. The dollar's trade-weighted index against other currencies has fallen by 7.5% during the past year. Since the start of April, however, the pound has weakened to $1.35, as a rise in UK interest rates became unlikely after the release of slowing Q1 GDP data for the UK.

| | | | | £ move (%) | |
|---|---|---|---|---|---|
| | **31.3.17** | **31.12.17** | **31.3.18** | **3m** | **12m** |
| $ per £ | 1.251 | 1.353 | 1.403 | +3.7 | +12.2 |
| € per £ | 1.189 | 1.127 | 1.141 | +1.2 | -4.0 |
| Y per £ | 139.3 | 152.4 | 149.2 | -2.1 | +7.1 |

[Source: Financial Times]




## Commodities

13. The oil price edged higher during the quarter, and in April the price of Brent crude went over $70 per barrel, its highest level since 2015. The price of Copper has continued rising, and has now gained 60% in the past two years. Metals prices surged higher in April after the US imposed sanctions on a number of Russian natural resource companies.

**Property**

14. In the quarter, the UK Commercial Property market was muted in the Office and Retail sectors, but Industrials continued to grow strongly, and have given a total return of over 20% in the past year.

| | 3-month (%) | 12-month |
|---|---|---|
| **All Property** | **+ 2.3** | **+11.3** |
| **Retail** | **+ 1.2** | **+ 7.1** |
| **Office** | **+ 1.9** | **+ 8.6** |
| **Industrial** | **+ 4.3** | **+21.6** |

**[Source: MSCI UK Monthly Index of total returns, March 2018]**

**Outlook**

15. The prospect of a trade war between the US and China has unsettled equity markets, with US negotiators making draconian demands on China. Russia's relations with the West have also deteriorated, after the responses to the Salisbury poisoning and the chemical weapon attack in Syria. The consequences of the US renunciation of the Iran Agreement, and the forthcoming US-North Korea talks, are foremost among other issues which could further destabilise equity markets.

16. The yield on the 10-year US Treasury bond has edged up to 3% in April, partly on fears of rising inflation, and partly on consideration of the enlarged US fiscal deficit to be funded in the bond market without the assistance of the Federal Reserve.

17. The long-awaited return of volatility is expected to remain a feature of equity markets in the coming months, and the geo-political uncertainties are likely to weigh heavily on markets.

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[Graphs supplied by Legal & General Investment Management]

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