MJ HUDSON Allenbridge

Oxfordshire Council Pension Fund

Quarterly Review Q2 2018

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OXFORDSHIRE COUNCIL PENSION FUND – 14 SEPTEMBER 2018

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. Growth forecasts for 2018 have been moderated since April, and the consensus forecasts for 2019 have also been lowered slightly. Levels of inflation in Western economies have eased since April.
(In the table below the bracketed figures show the forecasts made in April)

Consensus real growth (%)						**Consumer prices latest (%)**
	2015	**2016**	**2017**	**2018E**	**2019E**	
UK	+2.3	+2.0	+1.6	+1.3 (+1.5)	+1.4	+2.4(CPI)
USA	+2.4	+1.6	+2.3	+2.8 (+2.8)	+2.4	+ 2.8
Eurozone	+1.5	+1.6	+2.3	+2.2 (+2.4)	+1.9	+ 2.0
Japan	+0.6	+0.9	+1.7	+1.1 (+1.5)	+1.1	+ 0.6
China	+6.9	+6.7	+6.8	+6.6 (+6.6)	+6.3	+ 1.8

[Source of estimates: The Economist, July 7th, 2018]

2. In June the Federal Reserve raised US interest rates by 0.25%, to the 1.75 – 2% range, and signalled that two further rises were likely this year, as a response to the strong US economy and tightening labour market. The European Central Bank announced that its programme of bond purchases would halve to €15bn /month from October, and then cease at the end of 2018. It also indicated that no rise in interest rates was planned before mid-2019. In May the Bank of England deferred a rate rise in the light of the slowing UK economy, but on August 2nd it increased the interest rate from 0.5% to 0.75% - the highest level since 2009.

3. The round of import tariffs instigated by President Trump escalated as China retaliated against the 25% levy on certain Chinese imports by targeting US exports from politically sensitive US regions. A further round of US tariffs is threatened, even as the EU responds to the US tariffs on steel and aluminium which came into effect on June 1st. President Trump has been in the headlines constantly. His historic meeting with the North Korean President took place in June, after a fractious summit with G7 heads of state in Toronto. A later confrontation with NATO leaders was followed by a more harmonious

meeting with President Putin in Helsinki. His visit to Britain was carefully planned to avoid the mass demonstrations in the centre of London and other cities.

4. In Britain the divisions within the Conservative party over Brexit deepened. A Cabinet meeting at Chequers on July 6th appeared to have settled government policy on the issue, but within two days David Davis (Brexit Secretary) and Boris Johnson (Foreign Secretary) had resigned from the Cabinet.

5. The European political scene underwent several significant changes. In Italy the 5 Star movement and La Liga formed an improbable coalition, and installed Giuseppe Conte as Prime Minister, while the Spanish PM Mariano Rajoy was ousted after a parliamentary vote, and replaced by the Socialist leader Pedro Sanchez. In Germany the CDU/CSU majority party survived an internal row over immigration policy.

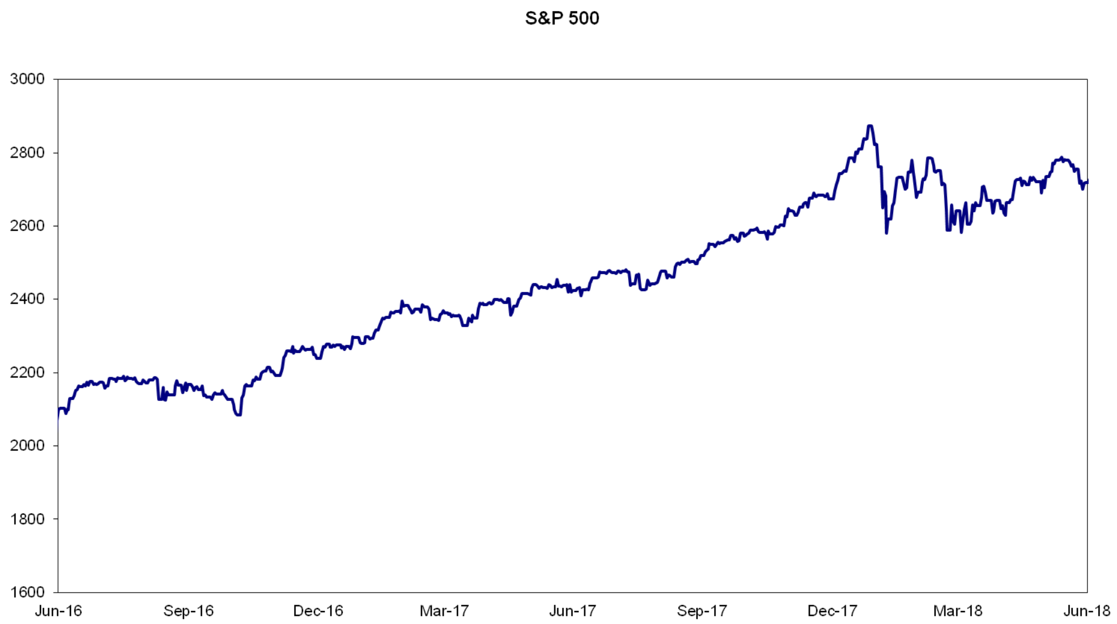
Markets

Equities

6. After the falls experienced in the first quarter of the year, equity markets rebounded strongly although at the end of June, North America was the only region showing a positive return for the calendar year to date. The scale of the rally in US equities (see graph below) was magnified in £ terms by the weakness of the pound relative to the dollar, which also contributed to the relative strength of the UK equity market.

	Capital return (in £, %) to 30.6.18		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**+6.0**	**+6.8**
55.4	FTSE All-World North America	+9.5	+10.3
8.4	FTSE All-World Japan	+3.0	+7.1
12.6	FTSE All-World Asia Pacific ex Japan	+1.3	+3.9
15.1	FTSE All-World Europe (ex-UK)	+1.2	-0.2
6.0	FTSE All-World UK	+8.2	+4.2
9.9	FTSE All-World Emerging Markets	-3.3	+3.0

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



7. The surge in the oil price during the quarter buoyed up the Oil & Gas sector, while Technology continued its recent strong run

	Capital return (in £, %) to 30.6.18		
Weight %	**Industry Group**	**3 months**	**12 months**
14.8	Technology	+10.4	+23.1
6.7	Oil & Gas	+16.3	+18.7
11.3	Consumer Services	+10.4	+12.2
4.7	Basic Materials	+5.9	+11.2
100.0	**FTSE All-World**	**+6.0**	**+6.8**
12.7	Industrials	+3.6	+4.9
10.5	Health Care	+8.9	+3.1
21.6	Financials	+1.0	+2.1
12.0	Consumer Goods	+2.6	-1.4
3.0	Utilities	+5.7	-1.6
2.7	Telecommunications	+0.7	-9.4

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

8. UK shares recovered strongly during April and May, before losing some ground in June. The Bank of England's decision not to raise interest rates in May caused a weakening of the pound which implies higher profits for UK companies with foreign-currency earnings.

(Capital only%, to 30.6.18)	3 months	12 months
FTSE 100	+8.2	+4.4
FTSE 250	+7.0	+7.7
FTSE Small Cap	+5.1	+5.2
FTSE All-Share	+7.9	+5.0

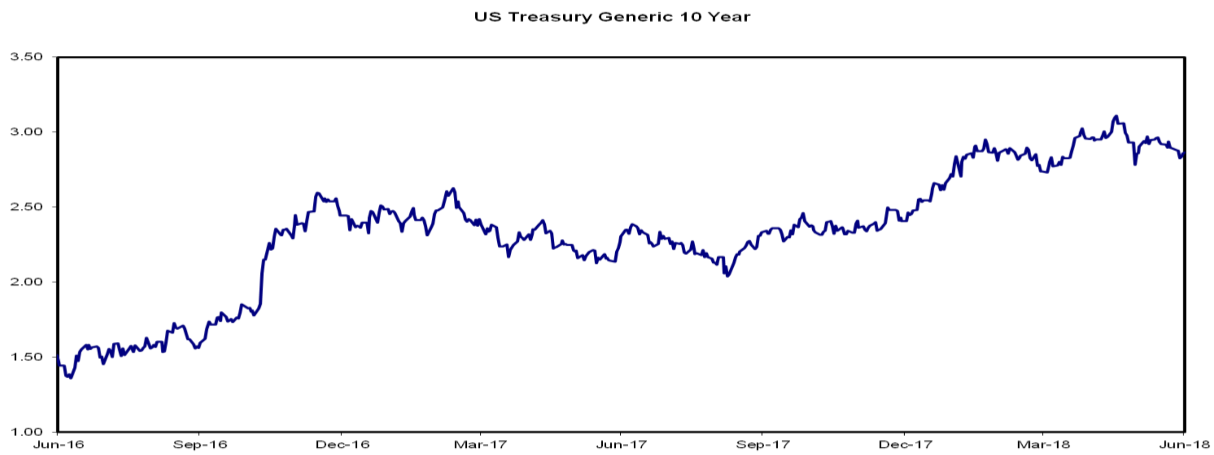
[Source: Financial Times]

Bonds

9. Despite the rise in short-term interest rates, longer-term US bond yields were little changed over the quarter, even though the 10-year yield briefly exceeded 3% (as shown in the graph below).

10-year government bond yields (%)					
	Dec 2015	Dec 2016	Dec 2017	Mar 2018	June 2018
US	2.27	2.46	2.43	2.75	2.84
UK	1.96	1.24	1.23	1.35	1.28
Germany	0.63	0.11	0.43	0.50	0.30
Japan	0.27	0.04	0.05	0.04	0.03

[Source: Financial Times]



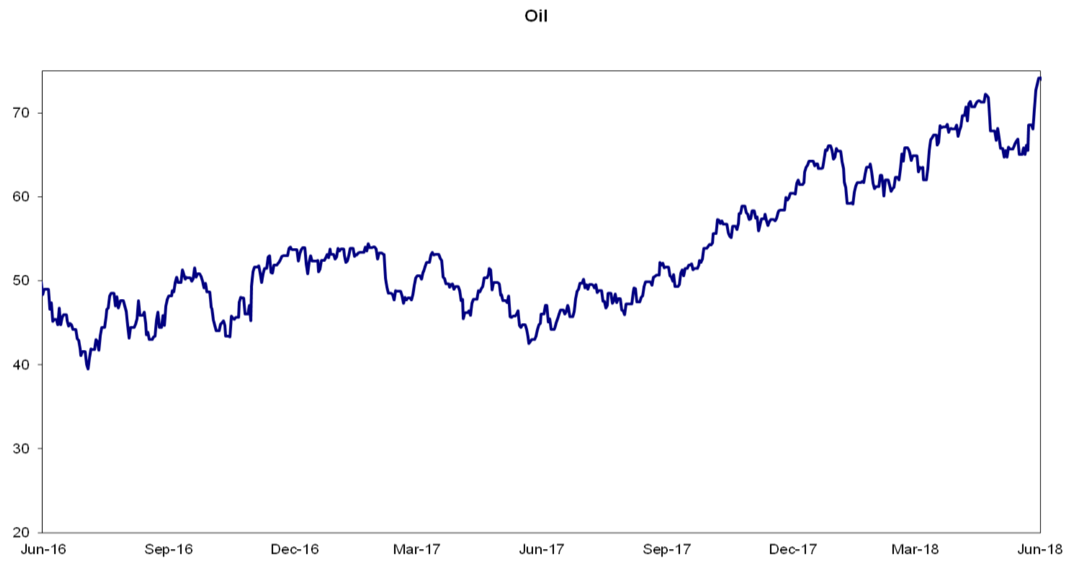
Currencies

10. The dollar was strong relative to the other major currencies, gaining almost 5% on a trade-weighted index basis. Sterling weakened after interest rates were held in May, but viewed over a 12-month period the currency cross-rates are almost unchanged.

				£ move (%)	
	30.6.17	**31.3.18**	**30.6.18**	**3m**	**12m**
$ per £	1.299	1.403	1.320	-5.9	+0.2
€ per £	1.139	1.141	1.131	-0.9	-0.7
Y per £	146.0	149.2	146.2	-2.0	+0.1

Commodities

11. The **oil** price continued to rise, partly on fears that the US withdrawal from the Iran nuclear deal would result in an embargo on exports of oil from Iran. The end-June Brent crude price of $79/barrel represented a rise of 14% in the quarter and almost 60% over the past year. **Copper** had reached its highest price for four years in early June, but then fell back sharply on concerns about a slowdown in China's economy, as well as the possible impact of US tariffs being imposed on Chinese imports.



Property

12. The recent pattern has continued, with the Industrial sector by far the most buoyant, while the Office and – especially – Retail sectors lagged well behind, albeit still delivering positive returns for the quarter and the year.

	3-month	(%)	12-month
All Property	**+ 2.2**		**+10.9**
Retail	**+ 0.5**		**+ 5.7**
Office	**+ 1.6**		**+ 8.3**
Industrial	**+ 5.1**		**+22.2**

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

Outlook

13. Equity markets appear to have recovered their equilibrium after the volatility in January/February, but looking at the returns more closely it becomes apparent that only the US equity market has made any gains this year, and this may be largely a result of the boost to corporate profits from the cuts in Corporation Tax. The escalating trade war between the US and China could have widespread impacts on companies' input costs. Meanwhile the uncertainty over the form that Brexit will take is a cloud hanging over UK and European companies.

14. The steady rise in US interest rates, together with the actions of other Central Banks, shows that the era of artificially cheap money is coming to an end, which limits the potential for further rises in equity or bond markets.

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August 6th, 2018
[Graphs supplied by Legal & General Investment Management]