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PENSION FUND COMMITTEE – 11 SEPTEMBER 2020

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. The lockdowns imposed worldwide to slow the spread of the coronavirus pandemic have inevitably had a severe impact on economic activity in the quarter: a 9.5% quarterly contraction in US GDP, 12.1% in the Eurozone, and 20.4% in the UK. Only China, which went into lockdown earlier, achieved positive growth in Q2. Forecasts for the full year 2020 have been revised lower since May in all regions other than China, as shown in the table below.

Consensus real growth (%)						Consumer prices latest (%)
	2016	2017	2018	2019	2020E	
UK	+2.0	+1.6	+1.4	+1.4	-9.4 (-4.7)	+0.6 (CPI)
USA	+1.6	+2.3	+2.9	+2.3	-5.3 (-3.5)	+0.6
Eurozone	+1.6	+2.3	+1.9	+1.2	-8.4 (-6.0)	+0.4
Japan	+0.9	+1.7	+0.7	+0.7	-5.4 (-5.2)	+0.1
China	+6.7	+6.8	+6.6	+6.1	+1.4 (+1.0)	+2.5

[Source of estimates: Economist Intelligence Unit, August 8th, 2020]

2. The UK Chancellor announced a further package of measures on July 8th, aimed at encouraging consumer spending by way of targeted reductions in VAT and discounts on meals. The budget deficit in 2020 is expected to reach 18% of GDP as a result of all the emergency stimulus measures introduced since March.
3. The US Federal Reserve announced in June that it would be buying corporate bonds, and the Bank of England increased its Quantitative Easing by £100bn, while the ECB increased its own bond-buying programme from €750m to €1.35bn. After tortuous negotiations, the EU agreed on July 21 to launch a €750bn Recovery Fund to assist European economies badly hit by the pandemic. €390 bn of this will be distributed by way of grants, with the remainder being loans.

4. There have been increasing numbers of new coronavirus cases in many of the American states and in Brazil, as well as localized outbreaks in Spain, Australia and the UK, among others. This has necessitated the closure of public spaces and the re-introduction of travel restrictions.
5. The death of George Floyd at the hands of Minneapolis police on May 25th triggered worldwide protests under the 'Black Lives Matter' banner, and the response of the US Federal authorities - notably in Portland, Oregon – has exacerbated the situation.
6. China's imposition of a new Security Law on Hong Kong in early July has provoked widespread condemnation, and relations between China and the West have deteriorated further with the decision by the US and the UK to ban Huawei from participation in the development of the 5G network.

Markets

Equities

7. The equity market rally which began in late March continued at a slowing pace during the quarter, with the result that the All-World Index ended June less than 1% below its end-2019 level. The UK market, however, lagged all other regions, and is well adrift over 1- and 3-year periods as shown in the following table.

	Capital return (in £, %) to 30.6.20			
Weight %	Region	3 months	12 months	36 months
100.0	FTSE All-World Index	+19.0	+3.3	+18.4
58.8	FTSE All-World North America	+21.3	+8.7	+34.0
7.6	FTSE All-World Japan	+12.1	+4.1	+7.6
13.2	FTSE All-World Asia Pac ex Japan	+18.8	+0.0	+5.9
14.0	FTSE All-World Europe (ex-UK)	+17.4	-2.2	+2.5
4.2	FTSE All-World UK	+ 8.8	-16.9	-16.0
10.9	FTSE All-World Emerging Markets	+17.9	-3.1	+4.8

[Source: FTSE All-World Review, June 2020]

8. US equities have recouped most of the losses sustained in February and March



Non-Confidential

...but UK shares are still well below February levels.



Non-Confidential

9. The surge in the **Technology** sector accounted for much of the gain in the global index, with **Health Care** and **Consumer Services** (two of the more resilient sectors in Q1) rebounding strongly. **Financials** continued to lag the broader market.

	Capital return (in £, %) to 30.6.20		
Weight %	Industry Group	3 months	12 months
21.0	Technology	+30.2	+37.4
12.1	Health Care	+14.9	+15.9
12.4	Consumer Services	+23.1	+9.5
100.0	FTSE All-World	+19.0	+3.3
10.9	Consumer Goods	+14.9	+1.3
12.0	Industrials	+20.8	-1.1
3.2	Utilities	+6.3	-2.0
2.7	Telecommunications	+7.7	-4.6
3.9	Basic Materials	+26.0	-4.9
18.1	Financials	+11.5	-14.1
3.7	Oil & Gas	+17.4	-33.5

[Source: FTSE All-World Review, June 2020]

10. The recovery in the FTSE 100 was hampered by the weakness in the Oil & Gas and Financials sectors.

(Capital only %, to 30.6.20)	3 months	12 months	36 months
FTSE 100	+ 8.8	-16.9	-15.6
FTSE 250	+13.4	-12.0	-11.5
FTSE Small Cap	+17.6	-10.0	-10.3
FTSE All-Share	+ 9.8	-15.9	-14.8

[Source: Financial Times]

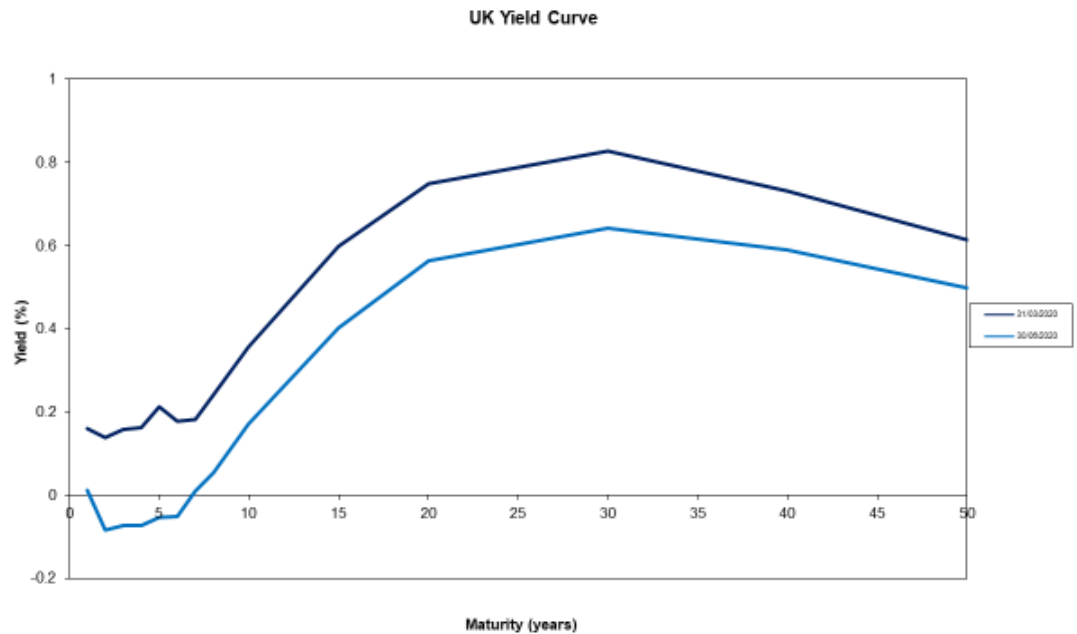
Bonds

11. Government bond prices rose during the quarter as yields reduced further, while corporate bonds continued their sharp rally as Central Banks stepped in to buy bonds as part of their quantitative easing programmes.

10-year government bond yields (%)					
	Dec 2017	Dec 2018	Dec 2019	Mar 2020	June 2020
US	2.43	2.68	1.92	0.69	0.64
UK	1.23	1.14	0.73	0.35	0.17
Germany	0.43	0.24	-0.19	-0.48	-0.46
Japan	0.05	-0.01	-0.02	0.01	0.03

[Source: Financial Times]

12. Yields on shorter dated gilts have turned negative.



Currencies

13. The pound was little changed against the dollar and the yen in the quarter, but lost ground against the euro. In July however, sterling rose by 6% against the dollar, reaching \$1.31, and also rose 4% on the yen and 1% on the euro.

	30.6.19	31.3.20	30.6.20	£ move (%)	
				3m	12m
\$ per £	1.273	1.240	1.236	-0.3	-2.9
€ per £	1.118	1.130	1.100	-2.7	-1.6
¥ per £	137.1	133.9	133.3	-0.4	-2.8



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Commodities

14. The oil price recovered after Saudi Arabia's announcement in May of a 1m barrels/day cut in production, but slowing economic activity worldwide kept demand low and the price remained below \$50.

(\$)	<u>30.6.19</u>	<u>31.3.20</u>	<u>30.6.20</u>	<u>3m (%)</u>	<u>12m</u>
Gold	1402.5	1618.3	1771.6	+ 9.5	+26.3
Brent crude	64.4	26.4	41.7	+58.0	-35.2

Property

15. The lack of transaction activity in the property market, combined with the uncertainties over rent payments, has meant that property valuations have in effect been temporarily suspended. Institutional property managers have generally frozen transactions in their funds because of the difficulty in establishing fair prices for investors buying or selling units.

Outlook

16. With the coronavirus pandemic having claimed 750,000 lives worldwide and increasing numbers of cases being reported in many regions, it is clear that the direct and indirect effects of the pandemic will dominate the economic outlook for a long while yet.
17. Fiscal and monetary actions have cushioned the impact in the short term, but in time the full effects of the pandemic will become apparent in

elevated levels of unemployment, corporate failures and, possibly, social unrest. Against this background it is hard to see equity markets continuing their recent rally, which has taken them close to the peak levels of February. Government bond yields, meanwhile, should maintain their current levels as central banks mop up the increased issuance and hold interest rates down.

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August 13th, 2020

[Graphs supplied by Legal & General Investment Management]

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