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PENSION FUND COMMITTEE – 7 JUNE 2019

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. The US economy grew at an annualised rate of 3.2% in Q1, although growth is expected to moderate during the remainder of the year. In the Spring Statement in March the forecast of UK growth in 2019 was just 1.2%, although the Bank of England has since raised its estimate of 1.5%. Economic indicators in Europe point to weak growth, while China has reduced its official forecast from 6.5% to 6 – 6.5%.

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

Consensus real growth (%)						Consumer prices latest (%)
	2015	2016	2017	2018	2019E	
UK	+2.3	+2.0	+1.6	+1.4	+1.0(+1.5)	+1.9(CPI)
USA	+2.4	+1.6	+2.3	+2.9	+2.2(+2.6)	+ 1.9
Eurozone	+1.5	+1.6	+2.3	+1.9	+1.3(+1.6)	+ 1.4
Japan	+0.6	+0.9	+1.7	+0.7	+1.0(+1.0)	+ 0.5
China	+6.9	+6.7	+6.8	+6.6	+6.3(+6.2)	+ 2.3

Sources of estimates: Economist Intelligence Unit, May 4th 2019]

2. The US Federal Reserve is not planning to raise interest rates for the rest of the year - in sharp contrast to its intentions last December to make two increases - while the European Central Bank resumed one of its support programmes in response to the weakening Eurozone economies.
3. Domestic news has been dominated by the UK government's so far unsuccessful efforts to gain House of Commons support for its withdrawal agreement to enable the UK to leave the EU. The deadline imposed by the EU has been deferred from March 29th to October 31st, but there appears to be little likelihood of any cross-party compromise which could lead to a Commons majority. With Mrs May's grip on the party leadership becoming

increasingly fragile, and European Elections due on May 23rd, it is impossible to forecast how the Brexit impasse will be resolved.

4. Until early May it appeared that US-China trade talks were proceeding well, and that an agreement would be reached. On May 5th, however, President Trump announced that the US would be increasing the tariff rate on \$200bn of Chinese exports from 10% to 25% on May 10th. These duly came into effect, with the Chinese government vowing to retaliate in kind. This development has unsettled equity markets.

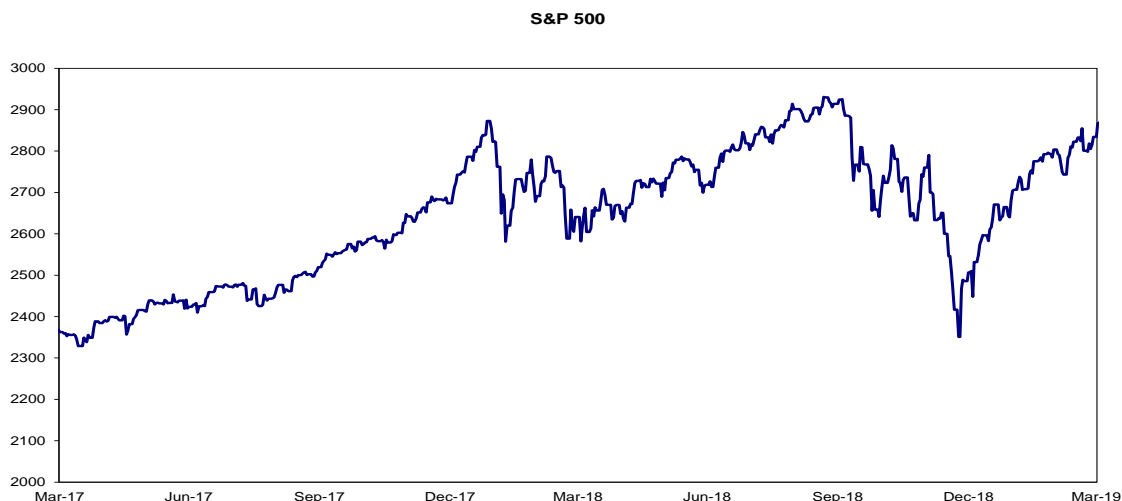
Markets

Equities

5. Equity markets recouped most of the falls experienced in the 4th quarter of 2018, and in April the S&P 500 Index passed its previous peak recorded in September. The 3-year figures show how much UK and Continental European markets have lagged the North American and Asian markets.

	Capital return (in £, %) to 31.3.19			
Weight %	Region	3 months	12 months	36 months
100.0	FTSE All-World Index	+ 8.9	+8.0	+40.7
56.7	FTSE All-World North America	+10.7	+15.1	+51.1
7.9	FTSE All-World Japan	+3.3	-3.1	+32.7
12.7	FTSE All-World Asia Pac ex Japan	+8.1	+0.9	+37.6
14.5	FTSE All-World Europe (ex-UK)	+7.4	-0.5	+25.0
5.4	FTSE All-World UK	+8.4	+2.9	+17.0
10.3	FTSE All-World Emerging Markets	+7.5	-1.0	+37.6

[Source: FTSE All-World Review, March 2019]



Internal

6. Sectoral returns in the quarter reversed the picture seen in the previous quarter, with Technology, Industrials and Oil & Gas rebounding sharply, while Utilities and Telecommunications lagged the rest of the market.

	Capital return (in £, %) to 31.3.19		
Weight %	Industry Group	3 months	12 months
11.0	Health Care	+4.6	+18.0
3.3	Utilities	+6.6	+16.8
15.9	Technology	+14.7	+16.0
11.3	Consumer Services	+9.6	+13.7
6.2	Oil & Gas	+10.7	+8.2
100.0	FTSE All-World	+8.9	+8.0
12.8	Industrials	+12.0	+5.8
2.8	Telecommunications	+2.8	+3.9
11.2	Consumer Goods	+7.9	+2.3
4.3	Basic Materials	+7.3	+1.5
21.2	Financials	+6.6	+0.8

[Source: FTSE All-World Review, March 2019]

7. In the UK, the All-Share Index gained 8.3%, after an 11% fall in Q4 2018, while the Small –Caps – which had been the most resilient area during 2018 – lagged the other areas of the market.

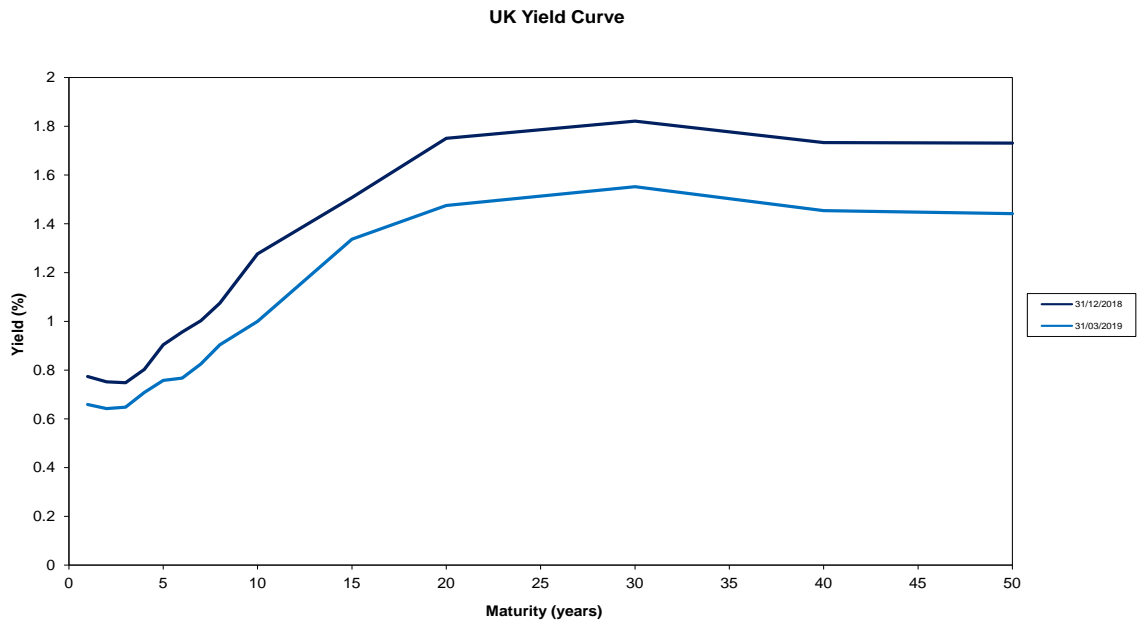
(Capital only%, to 31.3.19)	3 months	12 months	36 months
FTSE 100	+8.2	+3.2	+17.9
FTSE 250	+9.2	-1.8	+12.9
FTSE Small Cap	+5.6	+2.3	+20.3
FTSE All-Share	+8.3	+2.2	+17.2

[Source: Financial Times]

Bonds

8. The Federal Reserve's change of policy on interest rates announced in January and confirmed later caused yields on medium and long-dated US bonds to fall sharply. By late March the yield on 10-year US Treasuries had fallen below the 2.5% short-term interest rate. Yields in the other major government bond markets also declined, although was partly a reaction to the signs of economic slowdown and lack of inflation pressure.

10-year government bond yields (%)					
	Dec 2015	Dec 2016	Dec 2017	Dec 2018	Mar 2019
US	2.27	2.46	2.43	2.68	2.42
UK	1.96	1.24	1.23	1.14	1.00
Germany	0.63	0.11	0.43	0.24	-0.07
Japan	0.27	0.04	0.05	-0.01	-0.10



Internal

Currencies

9. Sterling continued to fluctuate as the prospects of Brexit on a 'no deal' basis waxed and waned. The weakness in the Eurozone economies depressed the euro against other major currencies.

	31.3.18	31.12.18	31.3.19	£ move (%)	
				3m	12m
\$ per £	1.403	1.274	1.303	+2.3	-7.1
€ per £	1.141	1.114	1.161	+4.2	+1.8
¥ per £	149.2	139.7	144.2	+3.2	-3.4

GBP vs EUR



Internal

Commodities

10. After its steep fall during the previous quarter, the Oil price rebounded sharply, gaining 25% to reach \$68/barrel (Brent crude) at end-March, and to exceed \$70 during April. This rally was caused by fears that supplies from Venezuela and Iran would be limited by the imposition of international sanctions, as well as by the reduction in Saudi Arabia's output.

Oil



Internal

Property

11. The UK All Property Index showed slowing annual growth for the 4th consecutive quarter, depressed largely by the severe weakness of the Retail

sector, where a number of well-known High Street names have either gone into administration or announced widespread store closures.

	3-month (%)	12-month
All Property	+0.5	+5.6
Retail	-1.3	-2.6
Office	+1.1	+6.5
Industrial	+1.7	+14.5

[MSCI UK Monthly Index of total returns, March 2019]

Outlook

12. While the steady raising of US interest rates has come to a halt, and equity markets have responded with a sharp rally, there are still a number of factors which could puncture this market sentiment. The US' recent imposition of higher tariffs on a large volume of Chinese exports threatens to hit world trade and depress growth. Meanwhile, the rebound in oil prices is likely to hit the economies of those countries which are reliant on imports of oil.
13. The extreme uncertainty on the UK political scene caused by stalemate in the Brexit process could be damaging to the UK economy and to the corporate sector, while governments in several European countries are losing ground to populist factions in local and national elections. In summary, it is easier to see negative influences on equity markets than positive ones.

Peter Davies
Senior Adviser – MJ Hudson Investment Advisers

May 13th, 2019

[Graphs supplied by Legal & General Investment Management]

8 Old Jewry, London EC2R 8DN, United Kingdom | +44 20 7079 1000 | London@MJHudson.com | mjhudson.com | mjhudson-allenbridge.com

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