QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

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OXFORDSHIRE PENSION FUND COMMITTEE – 4 DECEMBER 2015

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. The slowing trend of manufacturing output and job creation in the United States, together with signs of a slowdown in China, caused the Federal Reserve to hold US interest rates unchanged at its September meeting. The Eurozone area has been the only region to see an upward revision in its forecast GDP growth in 2015. The IMF's latest forecast of 3.1% global growth in 2015 would constitute the lowest level of annual growth in the past six years.

   (In the table below, bracketed figures show the forecasts at the time of the report to the September Committee)

   Source of estimates: The Economist, November 7th 2015

Consensus real growth (%)						**Consumer prices latest (%)**
	2012	**2013**	**2014**	**2015E**	**2016E**	
UK	-0.1	+1.7	+2.8	+2.5 (+2.7)	+2.3	-0.1(CPI)
USA	+2.2	+1.9	+2.4	+2.4 (+3.1)	+2.5	Nil
Eurozone	-0.5	-0.4	+0.8	+1.5 (+1.1)	+1.7	Nil
Japan	+1.9	+1.7	+0.3	+0.7 (+1.0)	+1.2	Nil
China	+7.8	+7.7	+7.4	+6.9 (+7.0)	+6.4	+1.6

2. On August 11th, the Chinese Central Bank suddenly announced that it would allow the currency to weaken slightly – having been very strong for the previous two years. In the event, the renminbi's parity against the dollar weakened by some 4% over the following days. This move was interpreted as a sign that China was concerned about its deteriorating balance of trade, but more broadly caused investors to question the prospects for Chinese economic growth. When combined with earlier volatility in the Chinese equity market, it was seen as a sign that the Chinese authorities were losing their grip on the economy.

3. This caused sharp falls in the Shanghai Composite Index, and the nervousness then spread to all world equity markets. Initially there was no official response in China, but on August 25th the Central Bank cut interest rates by 0.25% and eased bank reserve requirements. Short-selling was banned in China, and 'culprits' for the stockmarket's weakness were identified.

In response to doubts about the Chinese economy, commodity prices fell sharply, with the oil price falling 30% in July and August, before rallying in September. Base metal prices also weakened, on the expectation of reducing demand from China.

4. Days after the Greek parliament had approved the terms of the European bailout on August 14th, the Greek prime minister, Mr Tsipras resigned and a General Election was called for September 20th. This resulted in a renewed term for his Syriza party, again in coalition with the Greek National party.

5. The election of Jeremy Corbyn as leader of the Labour Party, and the announcements of the various campaign groups for the EU Referendum – which may take place in mid-2016 – seem likely to inaugurate a period of unpredictability on the British political scene.

Markets

6. **Equities** experienced their worst quarter for four years, with particular weakness in the Asian markets in response to the apparent travails of the Chinese economy, and depreciation of currencies in the region following the un-pegging of the renminbi.

	Capital return (in £, %) to 30.9.15		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**-6.4**	**-1.8**
54.6	FTSE All-World North America	-4.1	+2.5
8.4	FTSE All-World Japan	-8.7	+4.2
11.2	FTSE All-World Asia Pacific ex Japan	-14.1	-10.8
16.3	FTSE All-World Europe (ex-UK)	-5.0	-4.6
7.2	FTSE All-World UK	-7.0	-8.0
8.5	FTSE All-World Emerging Markets	-16.5	-15.2

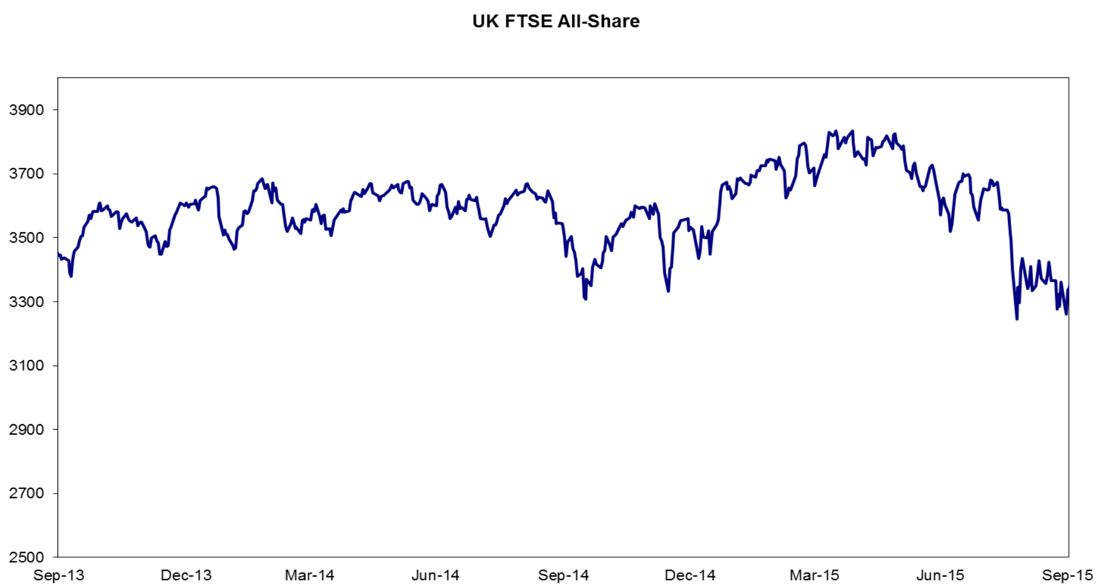
[Source: FTSE All-World Review, September 2015]

7. In the **UK equity market**, sharp falls in Mining companies – notably Glencore and Anglo American – were largely responsible for a greater fall in the FTSE 100 than in the mid- and small-cap sectors during the quarter.

(Capital only %, to 30.9.15)	3 months	12 months
FTSE 100	-7.0	-8.5
FTSE 250	-4.8	+8.5
FTSE Small Cap	-4.2	+2.4
FTSE All-Share	-6.6	-5.6

[Source: Financial Times]

8. In mid-September, the All-Share Index touched its lowest level for two years.



9. Globally, all equity sectors declined, with the energy and mining sectors once more seeing the weakest performances.

Capital return (in £, %) to 30.9.15		
Industry Group	**3 months**	**12 months**
Consumer Services	-1.5	+13.5
Health Care	- 5.8	+8.4
Consumer Goods	-2.1	+ 6.2

Technology	-3.0	+3.0
FTSE All-World	**-6.4**	**-1.8**
Financials	-7.9	-2.2
Industrials	-7.4	-3.1
Utilities	+0.4	- 3.7
Telecommunications	-7.4	-5.6
Basic Materials	-17.3	- 21.4
Oil & Gas	- 16.1	-30.7

[Source: FTSE All-World Review, September 2015]

10. Prices of **Government Bonds** in the 'safe haven' countries rose to end-2014 levels, on the expectation that global growth was slowing and that weak energy and metals prices would bring down the levels of consumer price inflation worldwide.

10-year government bond yields (%)					
	Dec 12	**Dec 13**	**Dec 2014**	**June 2015**	**Sept 2015**
US	1.76	3.03	2.17	2.32	2.06
UK	1.85	3.04	1.76	2.14	1.77
Germany	1.32	1.94	0.54	0.77	0.59
Japan	0.79	0.74	0.33	0.45	0.35

[Source: Financial Times]

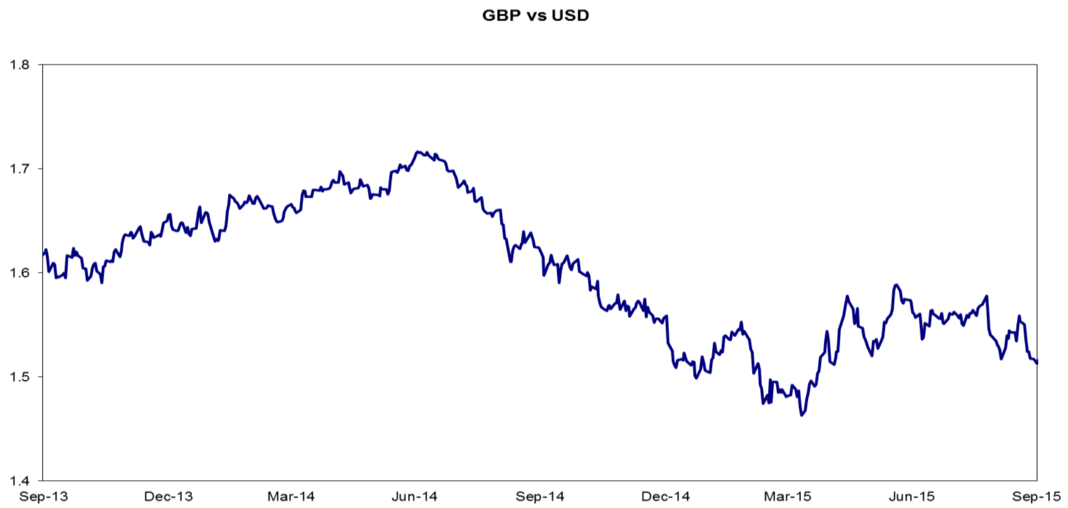
11. The yield spread of corporate bonds over government bonds continued to widen, mainly because of the higher level of risk in bonds issued by energy and metals exploration companies. The graph below shows the situation in the **UK corporate bond** market.

Currencies

12. Sterling lost ground against all three of the major currencies during the quarter, but is still strong against the Euro and Yen over 12 months.

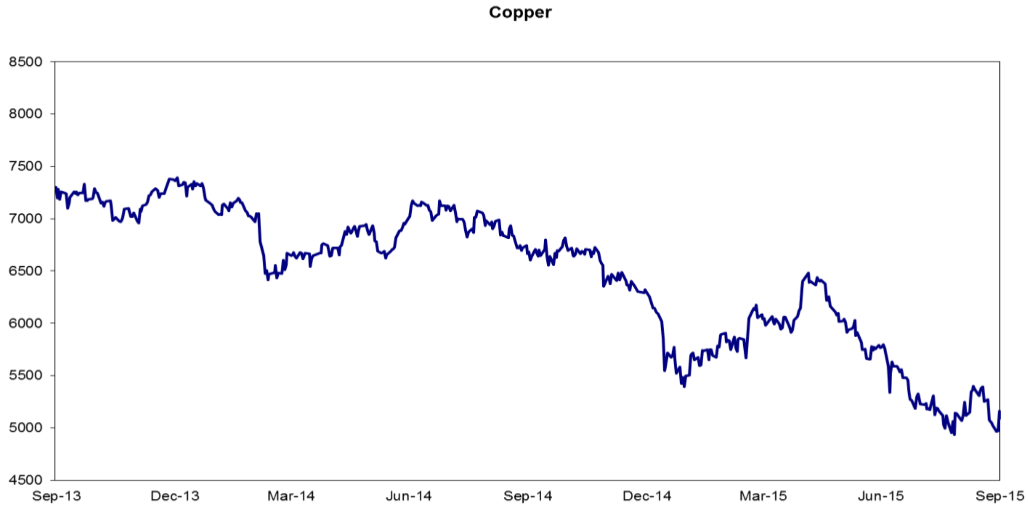
				£ move (%)	
	30.9.14	**30.6.15**	**30.9.15**	**3m**	**12m**
$ per £	1.621	1.573	1.515	-3.7	-6.5
€ per £	1.283	1.412	1.357	-3.9	+5.8
Y per £	177.8	192.4	181.4	-5.7	+2.0

[Source: Financial Times]

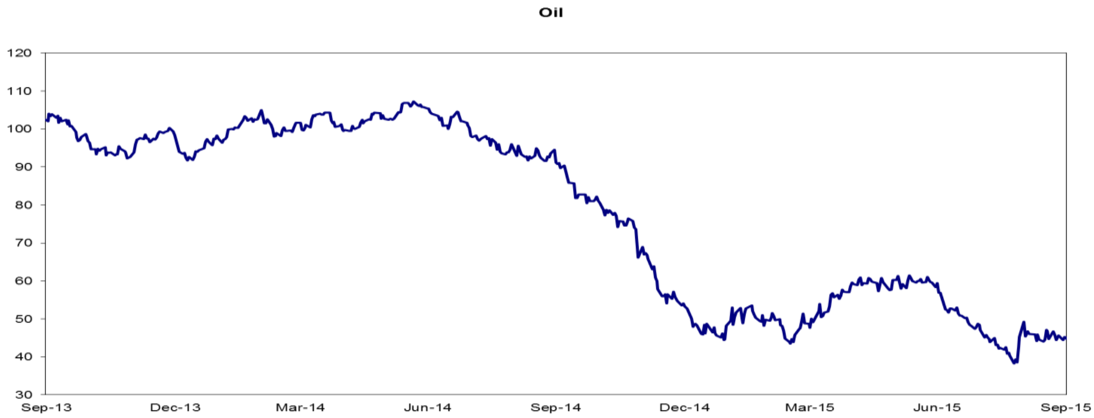


Commodities

13. In mid-August the price of **copper** fell below $5,000 per tonne – its lowest level for six years. The main cause was the expectation of lower growth from China (the consumer of 45% of world copper output), and also the likely moves from the Chinese authorities to stimulate consumer spending and downplay capital investment. Several of the major copper producers have since announced plans to close down some of their mines, in an attempt to rectify the supply-demand imbalance



14. The price of **oil** fell by no less than 30% between the end of June and mid-August: Brent Crude moved from $63 per barrel to $45, before recovering to $53 at end-August, but ending the quarter at $48.5. As with metals, the main reason was the sign of a slowdown in the Chinese – and hence global – growth, coupled with fears of over-supply.



Property

15. Despite the troubled equity markets, **UK Property** continued to report steady gains, with the Office and Industrial sectors once more outpacing Retail Property. The 12-month performance of property contrasts sharply with that of UK Equities during the same period, reinforcing Property's value as a diversifying asset class within a portfolio.

	3-month	12-month
All Property	**+ 3.4%**	**+15.3%**
Retail	**+ 2.2%**	**+ 9.5%**
Office	**+ 4.3%**	**+20.5%**
Industrial	**+ 4.6%**	**+19.7%**

[IPD Monthly Index of total returns, September 2015]

Outlook

16. In the third quarter, equity markets finally confronted the prospect of slowing growth in China and the United States, and fell sharply amid increasing volatility. Having previously welcomed the continuation of low interest rates by Central Banks, investors now began to worry about the impact on corporate profits – especially among highly-geared commodities producers.

17. This correction in equities has to some extent moderated the discrepancy between bond markets (priced for low inflation and low growth) and equity markets (priced for growth in corporate profits). The rebound in equity prices in October – when markets rose by some 5% – looks more like a technical rally than a reflection of any fundamental change in the economic backdrop. It is worth noting that on October 23rd the Chinese Central Bank again reduced interest rates by ¼%, and cut bank reserve requirements, to provide support for the property sector in China.

18. The strong US employment data for October have greatly increased the expectation that an interest rate rise will be announced at the mid-December meeting of the Fed. In the UK, however, the Governor of the Bank of England has indicated that interest rates are unlikely to rise before 2017.

19. With the scope for increased geo-political tension in Syria and the Middle East, together with the subdued economic outlook, it is hard to envisage equities gaining further ground after their October rally.

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[All graphs supplied by Legal & General Investment Management]