QUARTERLY REVIEW PREPARED FOR

Oxfordshire Council Pension Fund

Q4 2017

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Peter Davies

AllenbridgeEpic Investment Advisers Limited (Allenbridge)

Peter.Davies@allenbridge.com
www.allenbridge.com

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PENSION FUND COMMITTEE – 9 MARCH 2018

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. Economic growth in the 3rd quarter has exceeded expectations in most regions, and forecasts for 2018 have also been upgraded.

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

[Source of estimates: The Economist, January 13th 2018]

Consensus real growth (%)						**Consumer prices latest (%)**
	2014	**2015**	**2016**	**2017E**	**2018E**	
UK	+2.8	+2.3	+2.0	+1.6 (+1.5)	+1.4	+3.0(CPI)
USA	+2.4	+2.4	+1.6	+2.3 (+2.2)	+2.6	+ 2.2
Eurozone	+0.8	+1.5	+1.6	+2.3 (+2.1)	+2.3	+ 1.4
Japan	+0.3	+0.6	+0.9	+1.7 (+1.5)	+1.5	+ 0.5
China	+7.4	+6.9	+6.7	+6.8 (+6.8)	+6.5	+ 1.8

2. The Bank of England announced a ¼% rise in interest rate on November 2nd, while the US Federal Reserve is to start reducing its balance sheet by not re-investing the proceeds of maturing bonds. As expected, the Fed increased rates by ¼% in December and three more such rises are thought likely to take place in 2018. The European Central Bank is to halve its level of monthly bond purchases to €30bn from January 2018, with no specified end-date to the programme.

3. In the UK Budget on November 22nd, the official forecasts for UK GDP growth were revised down to 1.5% in 2017, and in the following four years to between 1.3% and 1.6% per annum. The Budget deficit will decline gradually from the current 2.4% of GDP to 1.1% of GDP in '22/'23. Public sector net debt is 86.5% of GDP in this fiscal year and will still be almost 80% of GDP in '22/'23.

4. Specific measures included the removal of stamp duty for most first-time buyers, funding to support the housebuilding sector, with penalties on the hoarding of undeveloped land, and more spending on infrastructure. Overall, the Budget contained £7bn of net tax cuts and £18bn of additional spending over the next six years.

5. The United States Congress passed the much-vaunted tax reform bill in December, which, amongst other measures, substantially cut the rate of Corporation Tax and also cut the top rate of Income Tax. While the US equity market welcomed the bill, the political impact of its apparent generosity to the wealthiest remains to be seen.

6. The **UK**'s negotiations with the EU over Brexit were allowed to proceed to the next stage, while Mrs May had to deal with three resignations from her Cabinet towards the end of the year, and announced a reshuffle in January. In **Germany** the CDU/CSU are moving closer to a renewal of their 'grand coalition' with the SPD, but the terms still need to be ratified by the SPD membership. Tensions in **Spain** increased after the call for independence from Catalonia; Madrid dissolved the regional parliament and assumed direct rule of the region pending a December election, which produced a narrow majority for the pro-independence parties. In **Japan**, Prime Minister Abe gained an important two-thirds majority in the Lower House in the October election.

Markets

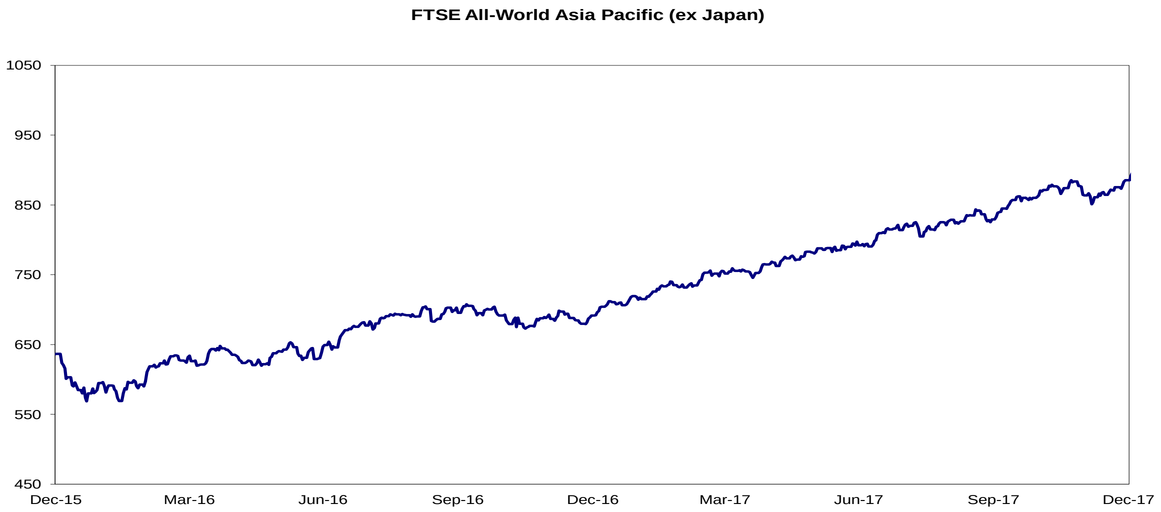
<u>Equities</u>

7. Shares ended the year strongly, with the passing of the US Tax Reform Bill providing an extra fillip in the final weeks of December. For the full year, the UK market lagged all overseas regions, as it had done in 2016.

	Capital return (in £, %) to 31.12.17		
Weight %	Region	**3 months**	**12 months**
100.0	FTSE All-World Index	**+4.6**	**+11.1**
54.2	FTSE All-World North America	+5.1	+9.1
8.6	FTSE All-World Japan	+7.7	+12.1
12.7	FTSE All-World Asia Pacific ex Japan	+7.0	+19.7
15.7	FTSE All-World Europe (ex-UK)	+0.2	+13.4
6.1	FTSE All-World UK	+4.2	+7.5
10.0	FTSE All-World Emerging Markets	+5.8	+17.6

[Source: FTSE All-World Review, December 2017]

8. Pacific Basin equities have risen by 50% since February 2016.



9. With the Technology and Basic Materials sectors again advancing strongly, it has been another year when 'growth' stocks have outpaced 'value' stocks. Oil & Gas, meanwhile, had a dull year after gaining nearly 50% in 2016.

	Capital return (in £, %) to 31.12.17		
Weight %	**Industry Group**	**3 months**	**12 months**
13.5	Technology	+8.0	+26.2
4.8	Basic Materials	+7.2	+18.0
12.9	Industrials	+4.2	+14.4
12.9	Consumer Goods	+4.1	+11.3
100.0	**FTSE All-World**	**+4.6**	**+11.1**
22.8	Financials	+4.6	+10.6
10.6	Consumer Services	+7.4	+9.6
10.2	Health Care	+0.6	+8.6
3.1	Utilities	-1.2	+2.3
6.2	Oil & Gas	+5.3	-4.8
3.0	Telecommunications	+0.0	-5.8

[Source: FTSE All-World Review, December 2017]

10. The mid- and small-cap sectors of the UK market have out-performed the FTSE 100 over the past 12 months, although they all performed similarly during the 4th quarter. For the year, the strongest UK sectors were Technology (+25%) and Basic Materials (+23%), while Utilities was by far the weakest (-15%).

(Capital only%, to 31.12.17)	3 months	12 months
FTSE 100	+4.3	+ 7.6
FTSE 250	+4.3	+14.7
FTSE Small Cap	+3.5	+14.9
FTSE All-Share	+4.2	+ 9.0

[Source: Financial Times]

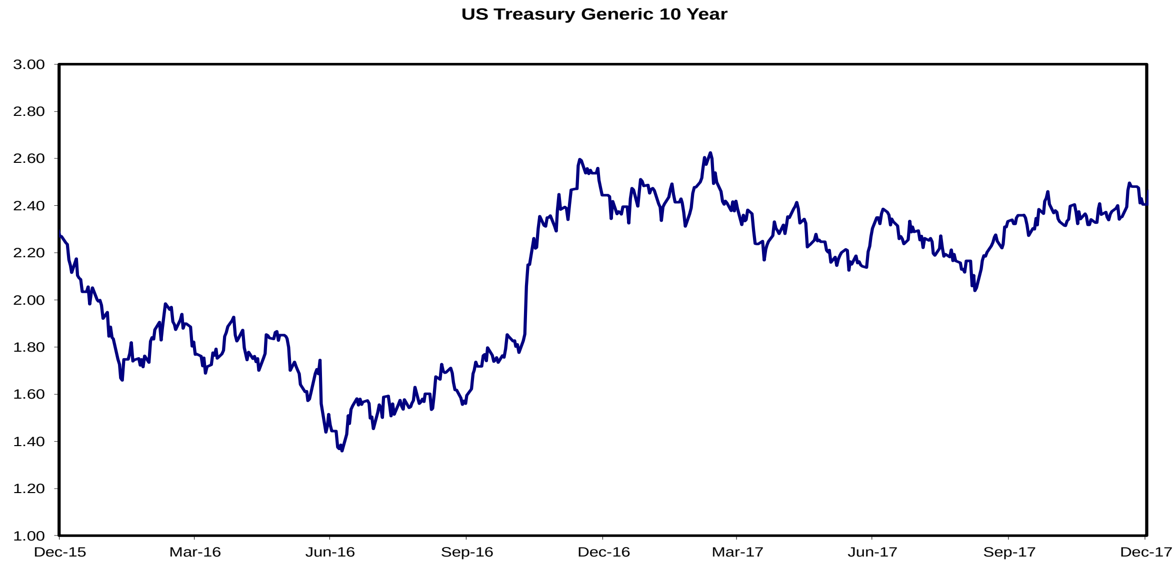
Bonds

11. The yield on US Treasuries edged upwards on the back of strong US economic growth and the December interest rate rise, but, as with the UK gilt yield, ended the year at its end-2016 level. With the recovery in Eurozone economic growth, Bund yields rose during the year from their exceptionally low level of December 2016, while Japanese 10-year yields stayed close to the Bank of Japan's target of 0%.

10-year government bond yields (%)					
	Dec '14	Dec 2015	Dec 2016	Sept 2017	Dec 2017
US	2.17	2.27	2.46	2.32	2.43
UK	1.76	1.96	1.24	1.41	1.23
Germany	0.54	0.63	0.11	0.47	0.43
Japan	0.33	0.27	0.04	0.05	0.05

[Source: Financial Times]

12. The yield on the US 10-year Treasury is now higher than it has been in the past two years



Currencies

13. The dollar and the yen continued to weaken during the quarter against the pound and the euro. In January 2018 the pound has reached $1.42 – its highest level since the EU Referendum in June 2016.

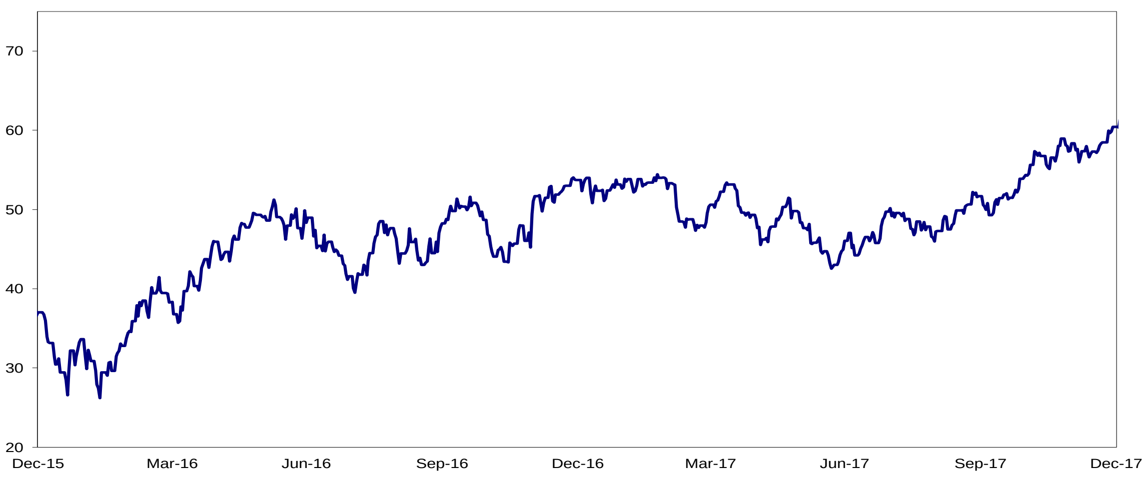
				£ move (%)	
	31.12.16	**30.9.17**	**31.12.17**	**3m**	**12m**
$ per £	1.236	1.342	1.353	+0.8	+9.5
€ per £	1.172	1.135	1.127	-0.7	-3.8
Y per £	144.1	151.0	152.4	+0.9	+5.8

[Source: Financial Times]

Commodities

14. The price of Brent crude continued its third-quarter strength, rising from $57 to $67 per barrel, its highest level for three years. Factors behind this rise include fears about the political unrest in Iran (the 3rd largest oil producer in OPEC), increasing demand for oil as global growth accelerates, and the continuation of supply restrictions agreed between OPEC, Russia and other big producers.

Oil



15. Copper has also risen on the improved outlook for global economic growth

Copper

Property

16. UK property returns maintained their gently accelerating progress through the year, with a full-year return of 11.2% comparing well with the 2.6% figure recorded in 2016. As was the case in 2016, Industrials were by far the strongest sector of the market.

	3-month (%)	12-month
All Property	**+ 3.4**	**+11.2**
Retail	**+ 2.0**	**+ 7.7**
Office	**+ 2.5**	**+ 8.5**
Industrial	**+ 6.4**	**+ 21.1**

[MSCI UK Monthly Index of total returns, December 2017]

Outlook

17. Although equity markets have continued to rise in recent months, encouraged by the positive outlook for growth in most regions, valuations as a multiple of profits are reaching historically high levels. Nearly two years have passed since the last significant setback in equity markets, and it would be rash to assume that this period of steady gains can continue for much longer – particularly when viewed against a background of rising interest rates, reducing central bank bond-buying programmes and the ever-present geo-political threats.

18. US government 10-year bond yields have moved up to 2.7% in January, which could presage similar moves in other government bond markets and impart a negative influence to equity valuations as future cashflows are discounted at higher long-term interest rates.

Peter Davies
Senior Adviser – AllenbridgeEpic Investment Advisers

February 2nd, 2018

[All graphs supplied by Legal & General Investment Management]