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OXFORDSHIRE PENSION FUND – 8 MARCH 2019

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. There are clear signs that the rate of economic growth is slowing in all regions. China's official figure for 2018 was the lowest for many years, with a further slowdown forecast for 2019. US growth is slackening, and both Germany and Japan reported negative growth in the 3rd quarter.

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

Consensus real growth (%)	**2015**	**2016**	**2017**	**2018E**	**2019E**	**Consumer prices latest (%)**
UK	+2.3	+2.0	+1.6	+1.3 (+1.3)	+1.5	+2.1(CPI)
USA	+2.4	+1.6	+2.3	+2.9 (+2.9)	+2.6	+ 1.9
Eurozone	+1.5	+1.6	+2.3	+1.9 (+2.1)	+1.6	+ 1.6
Japan	+0.6	+0.9	+1.7	+1.0 (+1.1)	+1.0	+ 0.9
China	+6.9	+6.7	+6.8	+6.6 (+6.6)	+6.2	+ 1.9

[Sources of estimates: 2018 – The Economist, 19.1 19, 2019 – Bloomberg consensus]

2. In mid-December the Federal Reserve announced its fourth rate rise of 2018, to a new range of 2.25- 2.5%. Initially two more rate rises were expected during 2019, but in a speech early in January the Fed Chairman implied that the next rate rise would be delayed, which boosted equity markets. The European Central Bank confirmed that QE would terminate at the end of December.

3. The UK political scene has been dominated by the approaching deadline for withdrawal from the EU. After several resignations from the Cabinet (including the Brexit Secretary), Theresa May postponed a parliamentary vote on the Withdrawal Agreement and survived a vote of no confidence from the Conservatives in December (after agreeing to stand down before the next General Election). In January the Withdrawal Agreement was roundly defeated in parliament, and the government then survived a vote of no confidence tabled by the Opposition. After another vote on January 29th, Mrs May was authorised to return to Brussels and try to negotiate changes to the Irish backstop arrangements in the Agreement.

4. In the United States, the Democrats took control of the House in the mid-term elections, but failed to overturn the Republican majority in the Senate. A succession of senior officials resigned (including the Attorney-General, the White House Chief of Staff and the US Ambassador to the UN). President Trump's sudden decision to withdraw US troops from Syria prompted the resignation of Defence Secretary Mattis.

5. In early December the US and China agreed to postpone for three months the escalation of tariffs threatened by both sides, in the hope that some agreement could be reached in the meantime. In late December a partial government shutdown began after President Trump refused to sign the Finance Bill unless it included a $5.7bn allocation to the Mexican Border Wall. The shutdown was temporarily lifted on January 25th after five weeks.

6. In France, widespread demonstrations by the 'gilets jaunes' caused President Macron to cancel his proposed fuel tax rise, and to improve pay and benefit levels for the least well off in France. In doing so he breached the fiscal deficit ceiling imposed by the EU – a fact which allowed Italy some leeway when re-framing their own Budget.

7. Elsewhere, the US and many other countries refused to recognise Nicolas Maduro as the legitimate President of Venezuela, and demanded that he stand down or call fresh elections. In Zimbabwe security forces cracked down violently on demonstrators angered by the doubling of the price of petrol.

Markets

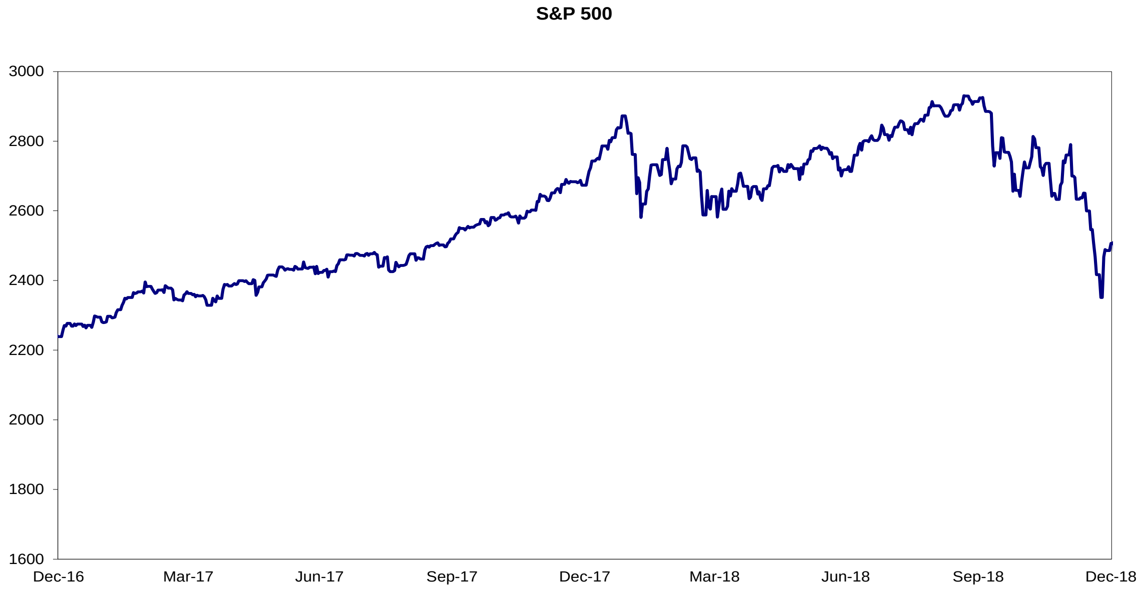
Equities

8. After the sharp falls in October, markets stabilised in November, but then experienced severe weakness and extreme volatility in December. Worries about the slowdown in global growth, the effects of a US-China trade war, rising US interest rates and disappointing results from some of the leading US technology stocks all played their part in the slide in equities. The 11% fall in the All-World Index marked the worst quarter for over 10 years, and the Index recorded its first negative year since 2011. As the table below shows, however, the 3-year return on equities has been strongly positive – except in the UK and, to a lesser extent, Europe.

	Capital return (in £, %) to 31.12.18			
Weight %	**Region**	**3 months**	**12 months**	**36 months**
100.0	**FTSE All-World Index**	**-11.0**	**-5.8**	**+32.1**
56.0	FTSE All-World North America	-12.0	-1.2	+41.4
8.3	FTSE All-World Japan	-12.6	-9.6	+21.7

12.6	FTSE All-World Asia Pac ex Japan	-7.0	-11.2	+32.5
14.8	FTSE All-World Europe (ex-UK)	-11.0	-11.9	+16.9
5.5	FTSE All-World UK	-10.7	-12.9	+7.0
10.3	FTSE All-World Emerging Mkts	-4.2	-10.3	+38.7

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



9. Technology stocks – which had been the strongest sector until September – fell sharply on disappointing results and regulatory concerns. Oil & Gas shares were badly hit by the fall in the oil price, while Industrials weakened on evidence of slowing economic growth. By contrast, the traditionally safer Utilities sector was the only one to gain ground in the quarter.

	Capital return (in £, %) to 31.12.18		
Weight %	**Industry Group**	**3 months**	**12 months**
11.5	Health Care	-7.3	+7.2
3.3	Utilities	+2.6	+3.4
11.4	Consumer Services	-10.8	+0.3
14.8	Technology	-14.9	+0.1
100.0	**FTSE All-World**	**-11.0**	**-5.8**
3.0	Telecommunications	-4.6	-8.4
6.1	Oil & Gas	-18.5	-9.9
21.6	Financials	-9.3	-10.1

12.5	Industrials	-14.3	-10.3
11.3	Consumer Goods	-8.7	-11.7
4.5	Basic Materials	-11.4	-12.8

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

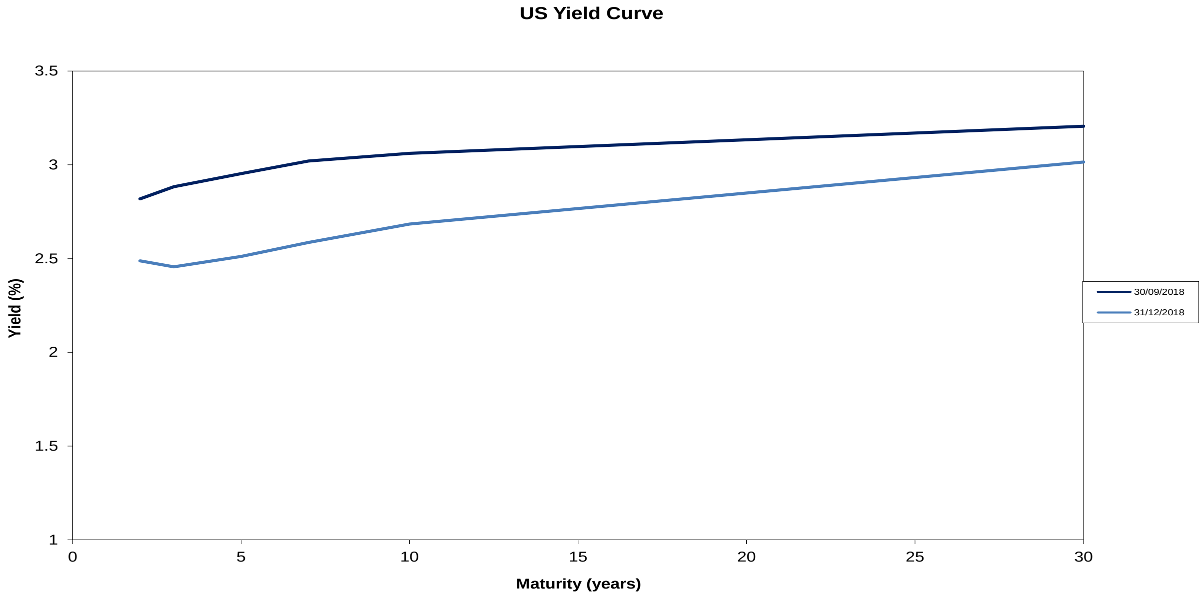
10. UK equities were not immune from the world wide weakness, in their case exacerbated by the domestic political uncertainty engendered by the Brexit negotiations. It is noticeable that the mid-cap stocks represented by the FTSE 250 - more domestically focussed that the FTSE 100 – have been markedly weaker than the large-caps over the past one and three years.

(Capital only%, to 31.12.18)	3 months	12 months	36 months
FTSE 100	**-10.4**	**-12.5**	**+ 7.8**
FTSE 250	**-13.8**	**-15.6**	**+ 0.4**
FTSE Small Cap	**-11.1**	**-12.4**	**+11.7**
FTSE All-Share	**-11.0**	**-13.0**	**+ 6.7**

Bonds

11. The increase in the US 10-year Treasury yield to 3.2% in October caused nervousness in equity markets, but the yield later fell back below 3%. As it declined further to 2.8%, however, fears grew that an 'inverted yield curve' was developing (when the 2-year yield exceeds the 10-year yield) as shown in the graph below. This has frequently been the precursor to an economic recession. The switch from weak equities to 'safe haven' government bonds played out in December, so that bond prices recorded healthy gains in the fourth quarter.

10-year government bond yields (%)					
	Dec 2015	**Dec 2016**	**Dec 2017**	**Sept 2018**	**Dec 2018**
US	2.27	2.46	2.43	3.04	2.68
UK	1.96	1.24	1.23	1.44	1.14
Germany	0.63	0.11	0.43	0.47	0.24
Japan	0.27	0.04	0.05	0.12	-0.01



Currencies

12. Sterling once again fluctuated as prospects of a Brexit agreement waxed and waned, reaching $1.30 when a resolution to the impasse appeared likely, but falling back to $1.27 periodically. The yen was the strongest of the major currencies over the quarter and the year.

				£ move (%)	
	31.12.17	**30.9.18**	**31.12.18**	**3m**	**12m**
$ per £	1.353	1.304	1.274	- 2.3	- 5.8
€ per £	1.127	1.123	1.114	- 0.8	- 1.1
Y per £	152.4	148.1	139.7	- 5.7	-8.3

Commodities

13. The oil price fell by one-third during the quarter, with Brent Crude moving from $83 to $54 per barrel. This was prompted by signs of a slowdown in China's growth rate and also by the increased supply of US oil from shale. In January the price recovered to above $60, partly because of the threat of sanctions on Venezuelan oil.

Oil

Property

14. The 7.5% total return for UK Property during the year represents a slowdown from the 11.2% recorded in 2017, but still compares favourably with the returns from equity and bond markets during the year. The Retail sector declined further during the quarter, and produced a negative total return for the year.

	3-month	(%)	12-month
All Property	**+ 1.1**		**+7.5**
Retail	**- 1.9**		**- 0.1**
Office	**+ 1.8**		**+7.3**
Industrial	**+ 3.4**		**+17.4**

[MSCI UK Monthly Index of total returns, December 2018]

Outlook

15. World equity markets have started the year strongly, recouping the losses sustained in December – although they still stand well below end-September levels. While further rises in US interest rates now look unlikely in the near term, other concerns – notably the progress of US-China trade negotiations, the White House/ Congress impasse over the border wall, and the developing crisis in Venezuela – will all weigh on the US market.

16. Closer to home, the Brexit situation, and the possibility that the UK will exit with no deal on March 29th, are likely to cause volatility in UK markets and currency for some months to come. European markets will additionally be confronted with the impact of slowing economic growth and the increasing influence of populist movements.

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February 6th, 2019
[Graphs supplied by Legal & General Investment Management]