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PENSION FUND COMMITTEE - 4 DECEMBER 2020

OVERVIEW AND OUTLOOK FOR INVESTMENT MARKETS

Report by the Independent Financial Adviser

Economy

1. Despite rebounding in the 3rd quarter, GDP in all regions except China is expected to show a sharp contraction for 2020 as a whole. In October the IMF forecast growth in 2021 of 5.9% in the UK and 3.9% in the US, although these may now need to be revised down because of the resurgence of the coronavirus pandemic since October. China's GDP growth for 2021 was forecast by the IMF at 8.2%. (In the table below, estimates made in August are shown in brackets).

Consensus real growth (%)						Consumer prices latest (%)
	2016	2017	2018	2019	2020E	
UK	+2.0	+1.6	+1.4	+1.4	-10.6 (-9.4)	+0.5 (CPI)
USA	+1.6	+2.3	+2.9	+2.3	-4.6 (-5.3)	+1.4
Eurozone	+1.6	+2.3	+1.9	+1.2	-8.3 (-8.4)	-0.3
Japan	+0.9	+1.7	+0.7	+0.7	-6.4 (-5.4)	+0.1
China	+6.7	+6.8	+6.6	+6.1	+1.8 (+1.4)	+1.7

[Source of estimates: Economist Intelligence Unit, November 7th 2020]

2. In September the US Federal Reserve announced that in setting interest rates they would be guided by the average level of inflation over a period rather than the spot level. This has been interpreted as meaning that US interest rates are likely to stay at their current level until 2023. The Bank of England announced in November it would increase its Quantitative Easing programme by £150bn.
3. As the incidence of new coronavirus cases began to rise again, regions of the UK imposed restrictions on movement and business activity. After a period of tiered restrictions, England went into a 4-week lockdown starting on November 5th. Government support via the furlough scheme was extended by five months until the end of March 2021. UK government debt is expected to reach 100% of GDP by April 2021.

4. Lockdown measures were already in force in France, Germany, Spain and other European countries, in an effort to stem the rising tide of coronavirus cases. In the US, the death toll has reached 250,000, but states differ in their response, with no clear direction from the White House.
5. Joe Biden won the US presidential election, although the Democrats have not achieved their anticipated majority in the Senate. Democrats will need to win both the run-offs in Georgia on January 5th in order to regain control of the Senate. If control remains in Republican hands, several of Biden's ambitious spending plans may not come to fruition.

Markets

Equities

6. While still buoyed up by the liquidity being injected by central banks, equity markets were prone to weakness when negative news on the spread of coronavirus came out. The UK market continued to lag all other regions.

	Capital return (in £, %) to 30.9.20			
Weight %	Region	3 months	12 months	36 months
100.0	FTSE All-World Index	+2.9	+3.3	+20.2
59.3	FTSE All-World North America	+4.1	+8.4	+38.2
7.5	FTSE All-World Japan	+1.5	+0.2	+9.2
13.6	FTSE All-World Asia Pac ex Japan	+3.7	+5.6	+9.0
13.6	FTSE All-World Europe (ex-UK)	+0.7	-2.7	-0.3
3.8	FTSE All-World UK	-4.8	-20.9	-20.7
11.2	FTSE All-World Emerging Markets	+3.5	+1.9	+5.0

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

7. Technology continued its strong run, and this contributed to the dominance of the US indices, which are over 20% concentrated in the five largest tech stocks. The gains in Consumer Services were largely attributable to the strength of Amazon.

	Capital return (in £, %) to 30.9.20		
Weight %	Industry Group	3 months	12 months
21.9	Technology	+6.7	+38.3
13.1	Consumer Services	+8.0	+14.9

12.0	Health Care	-0.2	+13.9
4.0	Basic Materials	+5.6	+3.9
100.0	FTSE All-World	+2.9	+3.3
11.2	Consumer Goods	+6.9	+3.1
12.4	Industrials	+6.1	+2.7
3.0	Utilities	-1.5	-10.5
2.5	Telecommunications	-4.3	-13.2
17.0	Financials	-2.6	-18.0
2.9	Oil & Gas	-16.3	-42.5

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

8. While the FTSE 100's progress was hampered by its high weights in Oil & Gas and Banking, mid-cap stocks rose on the partial re-opening of the UK economy.

(Capital only %, to 30.9.20)	3 months	12 months	36 months
FTSE 100	- 4.9	-20.8	-20.4
FTSE 250	+1.1	-13.1	-12.9
FTSE Small Cap	+0.6	-7.8	-11.8
FTSE All-Share	-3.8	-19.2	-19.0

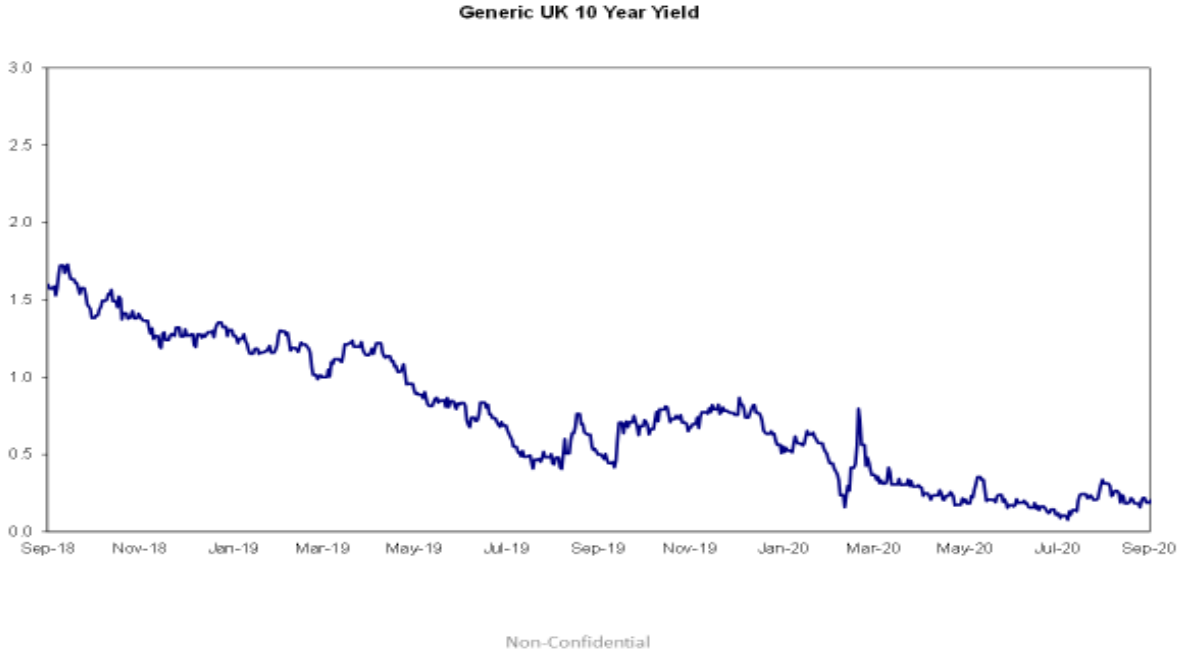
Bonds

9. Sovereign bond yields remained at historically low levels, as central banks continued to buy large quantities of government bonds.

10-year government bond yields (%)	Dec 2017	Dec 2018	Dec 2019	June 2020	Sept 2020
US	2.43	2.68	1.92	0.64	0.69
UK	1.23	1.14	0.73	0.17	0.23
Germany	0.43	0.24	-0.19	-0.46	-0.52
Japan	0.05	-0.01	-0.02	0.03	0.01

[Source: Financial Times]

10. The yield on 10-year UK gilts has been below 1% since the spring of 2019.



Currencies

11. The pound recovered lost ground against the dollar on optimism about the outcome of Brexit negotiations with the EU.

				£ move (%)	
				3m	12m
	30.9.19	30.6.20	30.9.20		
\$ per £	1.232	1.236	1.293	+4.6	+5.0
€ per £	1.130	1.100	1.103	+0.2	-2.4
¥ per £	133.2	133.3	136.4	+2.3	+2.4

Commodities

12. The oil price has remained stable around \$40 per barrel, while gold has continued to strengthen and copper has appreciated because of supply shortage and the resumption of growth in demand from China.

	\$	30.9.19	30.6.20	30.9.20	3m	12m
Gold		1283.1	1771.6	1884.0	+6.3%	+46.8%
Brent crude		56.7	41.7	42.0	+0.7%	-25.9%



Non-Confidential

Property

13. 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. The past 12 months' returns for Balanced Property Funds show a median return of -2.7%, with upper and lower quartiles of -2.0% and -4.0%. [Source: Association of Real Estate Funds, September 2020].

Outlook

14. The announcement on November 9th that the Pfizer/BioNTech vaccine had achieved 90% immunity in trials has created optimism that the coronavirus pandemic may be brought under control by mid-2021. While there is still uncertainty over the timing of authorization of the vaccine, and the logistics of mass vaccination programmes, this development has produced a sharp upturn in equity markets worldwide.
15. At a macro-economic level, however, higher levels of unemployment are expected even if economies normalize, as many sectors will have been forced to close operations permanently during lockdown or move to new business models requiring fewer staff. The increased issuance of government debt will also need to be financed.
16. Negotiations between the UK and the EU on a trade deal following Brexit are becoming very urgent, as the transition period ends on December 31st. The consequences of the eventual deal – or no deal – will begin to make themselves felt during 2021.

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November 18th, 2020
[Graphs supplied by Legal & General Investment Management]

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