Lincolnshire COUNTY COUNCIL Working for a better future

Regulatory and Other Committee

Open Report on behalf of Pete Moore - Executive Director of Finance and Public Protection

Report to:	**Pensions Committee**
Date:	**08 March 2017**
Subject:	**Independent Advisor's Report**

Summary:

This report provides a market commentary by the Committee's Independent Advisor on the current state of global investment markets.

Recommendation(s):

That the Committee note the report.

Background

Investment Commentary

March 2017

Climbing the "wall of worry" - politics again a major influence on markets in 2017?

Politics was clearly a major influence on markets in 2016, most notably in the USA (after Donald Trump's election as President) and in the UK (after the Brexit vote). This is unusual. Political events usually have only a short term influence over market sentiment – and hence over prices of securities. The exception is when political events can be expected to exert a significant influence over economic and financial matters – as has been the case in the two examples cited above.

The factors that largely determine the prospects for equity markets are the trends in profits and dividends, on the one hand, and the valuation rate of those profits and dividends, itself a function of long term interest rates, on the other. Of course, markets move quickly to "discount" events that they expect to happen – so perception rather than reality is crucially important. For bond markets and thus interest rates, the dominant influences are more difficult to identify; but they include inflation, supply and demand for government debt, the ageing profile of the population and international factors.

Equity markets have done well over the last three months or so, since Donald Trump's election as President. Virtually all markets are in a rising trend, with both the US and European equity markets up over 10% and the UK rather less so, at around 8%.

Recent political factors

President Trump was inaugurated as US President on 20th January. Perhaps the most controversial aspects of what he said in his inauguration speech were a potential trade war with China and the imposition of tariff barriers on imports into the US economy: best summarised as his “America First” policy. Both proposals are potentially destabilising for world trade – which has been a decisive factor in the growth of the global economy for the best part of 60 years. To date, the US equity market has focussed on the boost to the domestic US economy that such tariffs might provide. The risks to the rest of the world seem to have been ignored, real though they are. Of course, Presidential rhetoric is one thing and legislation to give effect to his proposals another. Particularly with regard to the proposed major re-structuring of the US tax code and its implied tax cuts. Time will tell. And we should not forget that this particular Republican Party President is by no means guaranteed to find it easy to get on with a Republican controlled Congress. So far, markets have reacted positively to the inauguration speech and chosen to ignore the chaotic nature of the new administration’s public announcements.

Just days earlier, Mrs May set out the high level topics that will form the backbone of the UK’s negotiating stance to take the UK out of the European Union. Her speech was generally well received. Whilst vocal critics of Brexit remain, many business leaders have expressed a willingness to focus on adapting their organisations to best cope with the uncertainties that lie ahead. Sterling strengthened after the speech and has held onto it gains since. As in the US, the UK equity market has so far reacted positively – choosing to ignore the uncertainties and complexities of the negotiations with the European Union that undoubtedly lie ahead.

Both of these speeches contained elements of great potential economic significance. In my view, they are positive for markets. But their impact is likely to be long term – with many short term worries interjecting.

Future political events.

These come thick and fast in Europe in 2017, starting with the Dutch election on March 15th where Geert Wilders, an extreme anti-immigration “populist” is likely to win the largest share of the vote. The French presidential elections – in a two stage process – take place in April and May; Marine Le Pen is likely to win through to the second stage process but whether she can actually win the French Presidency seems too close to call. A key plank of her policies is to reinstate the French franc and take France out of the Euro currency. If such a dramatic move came about, it would put the whole Euro currency in jeopardy.

The German election is in either September or October, where Angela Merkel is likely to be returned to power but in an awkward multi party coalition. And, an election in Italy cannot be ruled out, with a populist party waiting in the wings.

Conventional wisdom has it that a populist win in any of these elections would be negative for the local market concerned and maybe for European markets as a whole. I do wonder whether – in the event that the populists lose everywhere – that the political elite in the European Union will not see that as a signal that all is just fine: that much needed reform in the EU is not, after all, required. That could well be a long term negative influence on European equities, with a need for continuing low interest rates.

Markets

Equity markets have performed surprisingly well in the early months of 2017. They continue to climb the "wall of worry". Bond markets too have delivered generally positive, if small, returns – which is at variance with stance of the US Federal Reserve and the Bank of England – which are expected to increase short term interest rates in 2017. Long term US and UK interest rates had been rising since their low points last summer. That trend has now stalled and is being partially reversed. Whilst the investment portfolio of the Lincolnshire pension fund is probably at a record high value, and will have benefited the solvency of the scheme, the recent fall in the all important valuation rate adopted by the actuary to the scheme will have been an offset.

Conclusion

Peter Jones
27th February 2017

Consultation

a) Have Risks and Impact Analysis been carried out??

Yes

b) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the author of this report.

Background Papers

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