Lincolnshire COUNTY COUNCIL
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Regulatory and Other Committee

Open Report on behalf of Executive Director of Finance and Public Protection

Report to:	**Pensions Committee**
Date:	**13th July 2017**
Subject:	**Independent Investment Advisor's Report**

Summary:

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

Recommendation(s):

That the committee note the report.

Background

Equity markets close to all time "highs". Are they ready for a fall?

Equity markets continue to trade at or very close to record levels. Many investors are experiencing feelings of "vertigo". Surely, having risen for the best part of eight years, equity markets must be ready for a sharp correction? And yet, fixed interest markets – the other major asset class in which pension funds are able to invest – are also close to record high prices, i.e. record low yields. This is a dilemma facing every major institutional investor.

The financial crisis of 2008/09

It seems hard to comprehend that the financial and banking crisis - triggered by the Lehman Brothers bankruptcy - hit the world almost nine years ago. In the absence of concerted action from the governments of the major nations of the world, Central Banks around the globe were obliged to step into the breach. They, principally the US Federal Reserve, the Bank of England, the European Central Bank and the Bank of Japan, made dramatic and unprecedented moves: first to lower short term interest rates e.g. UK bank base rate; and second to purchase huge quantities of their own government and related debt, with a view to successfully engineering a fall in long term interest rates. The latter is sometimes referred to as Quantitative Easing – or QE for short.

The financial crisis led to a global economic recession and to inflation falling to very low levels. Central bankers were very fearful that the recession would rapidly turn into a 1930's style depression. Once in train, depressions are very difficult to

reverse as the history of the 1930's shows; that was brought to an end in part because of re-armament ahead of the second world war. So Central Bankers have left few stones unturned, in the past few years, in their combined efforts to stimulate their respective economies and to create a tolerable level of inflation – say 2% per annum.

The result of their actions was to flood the global financial markets with liquidity – the cash acquired by investors that sold government and other bonds to the Central Banks. The aim of the Central Banks was to benefit directly the corporate sector and individual consumers. A consequence – which continues – was that it drove up investment markets, almost without exception.

More buoyant economic news, globally

The economic news of the past few months has been surprisingly good and indicates that Central Banks are moving closer to achieving their objectives. All around the world, growth rates are improving, albeit modestly by historical standards. The USA and the UK have been growing at around 2% per annum for several years. Recently they have been joined by major European economies such as Germany and France. China continues to grow at around 6% annual rate. With the pick-up in growth, have come modest falls in unemployment and a welcome return of inflation. This scenario is a good one for equity markets.

Does this mean that Central Bank objectives have been achieved? Not yet. Central Banks continue to purchase large quantities of their government and other debt. As recently as August 2016, the Bank of England reduced its Base Rate to 0.25%. But the US Federal Reserve has begun to increase its short-term interest rate and did so again in mid-June. At some point there will be tapering off of QE, i.e. the purchase of debt, but this will undoubtedly be modest and undertaken cautiously. There are examples in the past of central banks withdrawing stimulus too hastily and aborting an early stage economic recovery.

Nonetheless, I suspect that commentators will look back on 2017 and conclude that this was the year when a watershed was reached – leading to a very gradual (glacially slow?) return to the financial norms of the past.

Stock market anxieties

There is an old stock market adage that equity markets "climb a wall of worry". And while there is plenty of good economic news, there are still things to worry about - mainly political, not least the recent UK electoral result. Uppermost in most investors' minds will be the malfunctioning US administration under the erratic Donald Trump; and the Brexit situation, where the chances of a "hard" Brexit appear to be rising in the wake of ever higher demands from both parties. And North Korea. That said, the populist fears surrounding the Dutch and French elections have not transpired.

So, what are the prospects for equity and bond markets? The key, I think, lies in the excess of liquidity referred to earlier. There is no early prospect of it being withdrawn, and when it is, I am sure it will be done only slowly. The Central Banks

have no incentive to engineer sharp market falls – in fact the exact opposite. They want the current high levels of confidence in companies and the private sector to become self-sustaining. So, I doubt that we shall see significant setbacks in either the equity or bond markets. Does that mean that there could not be an attack of the "jitters"? Obviously, not. But once a fall has extended to say 10%, especially in equities, I would expect the buyers to step in once again.

Peter Jones
24th June 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

This report was written by Peter Jones, who can be contacted via 01522 553656 or jo.ray@lincolnshire.gov.uk.

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