Regulatory and Other Committee

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

Report to:	**Pensions Committee**
Date:	**04 October 2018**
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

<u>Investment Commentary – October 2018</u>

<u>Economics, politics and Brexit.</u>

Whilst the weather this summer has been quite extreme – unusually hot and dry, at least in the UK – the same cannot be said for global investment markets. On the whole these have been pretty uneventful, with the exception of emerging equity markets. The US equity market has done well across the summer – up about 10% - whilst most others have traded sideways to slightly down. The fixed interest markets have been moribund, with yields hardly changing.

<u>Economics</u>

As far as economies are concerned, the USA has powered ahead. The recent data shows growth of close to 4% per annum and inflation approaching 3%. This scenario leads to rapid growth in earnings per share, with many companies revealing increases of well over 10%. This sort of economic environment amply justifies the “bull market” we are seeing in US equities. It is leading to increases by the US Federal Reserve in its short term interest rate in order to try to keep inflation from running out of control. US unemployment is below 4%, nationally, which in the past would have provoked the fear in equity investors of excessive inflation. So far, the equity market has continues on its merry – even euphoric – way. But wage inflation is showing signs of resurgence (having previously been surprisingly well behaved, in spite of the low level of unemployment). If wage increases rise further, some adverse market reaction is probable.

Elsewhere, outside the US, economic growth has been much less robust. In most places the optimism of the early part of 2018 has given way to a slight slowing of growth and a damping down in prospects. There is a growing sense of anxiety about the health of non-US equities among investors. Excessive inflation is not, so far, seen as likely to cause a problem.

<u>Politics</u>

And yet, the political scene has been far from quiet. Most are well known to members of the committee. President Trump and his trade war with China; his long running rows with Congress and his own party ahead of elections this autumn. There is the increasingly acrimonious debate within the EU about immigration. Relationships between Russia and the rest of the world have been deteriorating. And there are the long running wars in the Middle East, Syria in particular. All of these have had the capacity to unhinge markets – but have shown no signs of doing so. On the other side of the coin, there has been a dramatic improvement in the previous legitimate concerns over North Korea and its nuclear arsenal.

We should not forget the global liquidity situation, which in my view overwhelms everything else by its magnitude. I refer to the programme of Quantitative Easing embarked upon by all the world's central banks after the financial crash and which has led to interest rates at levels so low as to be barely comprehensible. Some of the central banks are now raising short term interest rates and slowly withdrawing the liquidity – "Quantitative Tightening" – to use the jargon, but only very slowly and cautiously. I expect the US economy to continue to expand well into 2019 and to provide some buoyancy elsewhere around the globe.

To summarise, I think excessive liquidity and economic expansion will keep equity markets close to their current high levels. As before, statistically both equities and bonds are overpriced (especially bonds) but I do not expect this to change anytime soon.

<u>Brexit</u>

Brexit dominates the headlines here in the UK, but elsewhere, including within Europe, barely raises a yawn. It is not a significant factor in influencing global equity prices. Nor, perhaps perversely, in UK equities. A "no deal Brexit" could well send sterling lower, but because of the huge overseas influence on most FTSE 100 companies has the effect of strengthening UK equities.

I find it difficult to conceive that there will be a "no deal Brexit" – for a number of reasons. Are EasyJet and Ryanair really going to stop flying between the UK and Europe on 29th March 2019? And are the exporters of Germany and France (cars and foodstuffs including wine, respectively) going to surrender their markets in the UK? Above all, there is the European Commission's budgetary problem. The UK is the second or third largest contributor to the EU budget and without us, Germany and France must contribute more – which is politically verging on the impossible. There is a story that Mrs May agreed the infamous €39 billion unconditionally. Can the UK government be that naïve a negotiator? So I expect a short term agreement by late March 2019 and an extended transition period to sort out other less time sensitive issues.

We can talk more about Brexit when we meet on 4th October.

Conclusion
Peter Jones
18th September 2018.

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

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

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