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:	**10 January 2019**
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 – January 2019

Markets in turmoil

After a quiet summer in markets across the world, recent months have been anything but. For a number of years, almost back to the start of this decade, declines in equity markets had been limited to 10% or so. I certainly attributed this to major institutional investors lacking serious alternative investment opportunities. The other major market – the various government bond markets around the globe – offered such low yields that they were unattractive to all but a small niche of buyers. The commercial property market, whilst large, is difficult to invest in quickly and expensive to do so. So has the phenomenon - of limited falls in equities - broken down?

Global Economics

The trigger for weakness in US equities in October seemed to stem from the belief, no doubt well founded, that the US economic growth rate would ease back in 2019. During the summer of 2018, stimulated by the Trump tax cuts, it was growing at about 4% per annum. But the stimulus of tax cuts does not last indefinitely. Many commentators think the growth rate will fall in 2019 to around a still respectable 2.5%. No disaster, but enough to result in more subdued rates of growth in US profits and earnings per share.

Outside the US, as one commentator put it, the air was slowly escaping from the economic balloon of the rest of the world! In early 2017, Germany and other European economies surprised us all with a robust upturn. Just as suddenly it seems to be subsiding. Surprisingly, the UK seems to be – so far anyway – coping well with the Brexit "pantomime". The summer of 2018 saw good growth, which seems to be sustained at around 1.5% per annum. Not wonderful but enough to keep unemployment in a modest downward trend.

China and the USA

The trigger for raising greater anxiety in global equities was the threat of a trade war between China and the US. But most observers thought even this was resolvable. China and the US are like a married couple who cannot divorce but must live together. They are inter- dependent. They must find a day to day working modus operandi. What seems to have led to sharp falls of over 3% on successive days was the arrest of Huawei's Finance Director in Vancouver in early December, with a view to her extradition to the US on criminal charges relating to Iran. Quite how this saga will play out is not at all obvious to me – or seemingly to markets at the time of writing. Huawei is a Chinese manufacturer of telecoms equipment widely used in the western world. It is believed to be an arm of the Chinese government (which the Chinese deny) and thus constitutes a major threat to the security of western digital networks.

Global Bond Yields

The Committee will be well aware that the Quantitative Easing programmes initiated by all the main Central Banks around the world have led to the injection of huge amounts of liquidity into markets. It is this, overwhelmingly, that has sustained the huge rise in global equities and the fall in long dated government bond yields. Since early 2018, the US Federal Reserve, the US Central Bank, has begun to withdraw some of this liquidity by selling US Treasury Stocks. Other Central Banks are expected to follow suit, albeit cautiously, in 2019. So government bond yield began to rise. For example, US Treasury 10 year yields rose to 3.25% in November from some 2.5% at the start of 2018. Amidst the recent equity market turmoil, there has been an abrupt reversal – representing a "flight to safety". That same security now yields around 2.85%.

Implications for Global Equities

Global bond yields are once again at unattractively low levels. That leaves global equities as the major investible alternative for institutional investors – unless that is they are prepared to build up their cash holdings to high levels. In the US – but not elsewhere – rates for money on deposit are now more attractive than they have been since the financial crisis of some ten years ago. With the end of the calendar year approaching (at the time of writing) – cash will be an attractive holding for many investors. But as 2019 unfolds, despite a slowing global economy, I suspect buyers of equities will once more return.

Conclusion

Peter Jones
16th December 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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