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:	**21 March 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 – March 2019

Equity Markets' astonishing rise this year

The change in equity market sentiment since the start of 2019 has been nothing short of astonishing. The last week of 2018 – admittedly a week when little trading took place – was one of doom and gloom, in part related to the US Government shut down over the proposed "Mexican Wall". But the New Year started with a bounce back in prices, not surprising in view of the previous negativity. And yet the global equity markets have kept on rising, in a more or less unbroken trend now extending to 8 weeks. The US market has risen around 15% over the period and most European markets around 10%. The UK market is up only 5%.

Bond markets, especially the US Treasury Bond market and that of UK gilts, have been largely unchanged so far this year.

What has changed – and what not changed?

To take the latter topic first, the deterioration in economic growth conditions is continuing, not only in the USA (growth this year of around 2%), but especially in continental Europe – which is coming close to stagnating. The UK seems to be growing at about 1% per annum despite the Brexit uncertainty. Views on the health of the Chinese economy are mixed but the Chinese authorities have provided

some modest financial stimulus - which suggests some softening in current economic conditions.

What has most definitely changed is the attitude of global central bankers. The US Federal Reserve (the central bank of the US) had previously indicated that it envisaged two if not three increases in short term interest rates in 2019; from 2.5% to over 3%. It has now reversed tack and indicated that it is happy with the current level. The Bank of England had previously indicated no change in rates until the Brexit issue sees some resolution. But the European Central Bank and the Bank of Japan have to some degree followed their US counterpart and indicated that they are in no hurry to raise rates. All of these central bank changes in stance have benefitted sentiment in equity markets.

A further – and important - change in central bank policy is regarding Quantitative Easing. These were the policies initiated in response to the global financial crisis of 2009/10 whereby central banks bought prodigious amounts of their own government debt to assist the banking industry and generally with a view to stimulating their economies. The US Federal Reserve had already started to reduce its holding of such debt with a view to "normalising" matters (by selling US Treasury Stock back to the market) and indicated in late 2018 an intention to press on with such a strategy. Early 2019 has seen a rethink of the policy, which appears to be on hold. This has also improved market sentiment.

International trade tensions

President Trump's "make America great again" had negative impacts on equity markets in 2018. These largely reflected attitudes to the US/China trade talks on tariffs and on intellectual property rights. It does not look likely that the tensions will be resolved for some months. Yet, equity markets appear to be taking an optimistic view of the outcomes. It is possible to sympathise with this view, to the extent that the two economies of China and the US are so closely inter- twined that it is in neither's interest to provoke a breech. Rather like a married couple perhaps where divorce ought to be very much a last resort!

But a brief consideration of the global market for motor vehicles and components sheds some light on the risks. The Chinese car market is very large, over 50% bigger than the US. That market is now in decline; indeed the whole global motor market is in decline, witness the latest announcements from Honda UK and Nissan UK that they were likely to close their UK factories as being sub-scale. US manufacturers export meaningful volumes to the Chinese markets, ironically, many of these are Mercedes/BMW brands manufactured in the USA. The pressure on Germany and its huge reliance on its manufacturing base becomes clear. This is indeed a global issue.

Brexit deadline?

By the time the committee next meets, the 29th March deadline will almost be upon us. It would be a mistake to regard that as “the end of the story”. The EU Commission seemingly regards the Euros 40 billion or so of UK obligations under the withdrawal agreement as payable whatever the 29th March outcome. First payments are due into the European budget by the end of April 2019. Whether the UK government actually agreed to unconditional payments, I have no means of knowing. It seems an appalling negotiating tactic, if true.

If there is a hard Brexit, there are a whole host of (temporary?) arrangements to be put in place, to include airline flying rights, fishing quotas, food tariffs etc., to quote some obvious ones.

Market prospects

Equity markets have run up quite a long way so far this year. There is certainly room for optimism compared to late 2018. My instinct is that the current excess of optimism will fade and result in more subdued equity markets. I doubt that either equity or bond markets will fall by any appreciable amount in the next few months. Cash flows into financial markets remain substantial.

Conclusion
Peter Jones
28 February 2019

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.

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