Regulatory and Other Committee

Open Report on behalf of Andrew Crookham, Executive Director – Resources

Report to:	**Pensions Committee**
Date:	**09 January 2020**
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 2020

Stand-off in investment markets? Low long term returns in prospect.

Recent market movements

The year 2019 has been a good one for investors. Equities have risen across the globe – by an astonishing 25% in the USA. Other regions around the world have shown increases approaching 20%, including the FTSE 250 index of largely UK based companies. The benchmark FTSE 100 index is up only 10%; it is composed of mainly global companies who earn their profits outside the UK and has been negatively impacted by the strength of the £ sterling. Share prices were, of course, abnormally depressed at the end of December 2018. Bond yields have fallen substantially in 2019, especially at long maturity durations favoured by pension schemes, so bond prices have risen. Hence, there have been substantial increases in the value of portfolios, almost without exception. And yet, there is no doubt that nervousness about these elevated market values is rising amongst professional investors. Markets seem to be reluctant to push much higher. What will 2020 bring?

Markets continued trust in Central Banks

The global economy is experiencing a slow down in its growth rate. But it is at a measured pace and does not seem to be accelerating downwards, despite continued anxiety about the state of world trade as a result of the arguments between the USA and China. There are industries where the falls are significant – the most obvious being the motor vehicle industry. And yet others, eg media, are growing robustly. But, in general, nation states are not experiencing recessionary conditions and their Central Banks will do “whatever it takes”, to quote the words of Mr Draghi, former chairman of the European Central Bank, to see that this does not happen. Short term interest rates continue to trend downwards and may have somewhat further to fall, though some are so low (eg in Europe and Japan) that they are approaching their limits. Expectations are for the US Federal Reserve to keep US short term interest rates on hold for 2020. The markets continue to trust the Central Banks to take the necessary actions, if they are faced with an accelerated economic downturn.

UK prospects for 2020

The decisive outcome of the UK general election does at least provide political stability. It is perhaps too early to attempt precise economic forecasts. Nonetheless, many decisions to invest – by companies in capital projects and by individuals, eg in house purchase - had been deferred and may now be activated. This should provide a welcome boost to UK economic growth, now at around 1% per annum.

Global prospects for 2020

At the time of writing in mid-December, market conditions are benign. Last December saw sharply elevated anxiety about global growth that led to panic in many markets, Wall Street in particular. That episode was exacerbated by very thin markets approaching Christmas and the New Year. Many funds account and report on a calendar year basis and are unwilling to make material changes to their portfolios after mid-December. So, natural long term buyers are absent leaving hedge funds to dominate thin markets with little turnover. As we now know, the US Federal Reserve abruptly changed its previous tightening stance, and January 2019 saw a sharp rise in equity markets, reversing all the falls of late December. Hopefully, there will be no repeat this year.

The yield on the principal government bond markets of the world had fallen to very low levels in 2019. Often the investment returns of such bonds held to maturity is negative, which seems bizarre to non-practitioners. Usually, the underlying logic is to immunise the liabilities against which such assets are being invested from changes in bond yields, especially downwards. But as an investment chosen on their merits alone, compared to say equities or property or venture capital, they have few supporters. The consequence is that global equities are likely to be supported in 2020. Any fall in prices approaching say 10% should see buyers emerge.

Longer term investment returns

The prices of global equities and global bonds are high; in many case at all time highs. Economic prospects are certainly not stellar – but they are respectable. The primary driver for the significant gains has been – and I think will continue to be – Central Bank intervention to prevent either economic recession or inadequate levels of inflation. A consequence is that further large price gains will be muted. So annual returns in the medium to long term on portfolios of stocks and bonds, such as that of the Lincolnshire County Council pension fund, are likely to be low, by historical standards. Probably below 5% per annum for global equities and lower (probably much lower) for bonds.

Peter Jones

17 December 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.

Background Papers

No Background Papers within the meaning of section 100D of the Local Government Act 1972 have been used in the preparation of this Report.

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