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:	**11 January 2018**
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

Stock markets close to a peak in 2018?

Favourable economic prospects for 2018

The economic prospects for the global economy in 2018 are benign – just as they were in 2017. Growth in 2017 was around 3.5% globally, over 2% in the USA, somewhat under 2% in the Eurozone and around 6% in China: the UK was the laggard at say 1.5%. Most commentators have growth forecasts that are not materially different in 2018. A "goldilocks" scenario is the expression that springs to mind – neither too hot nor too cold. In other words, a scenario that is unlikely to trigger decisive central bank action to rein in excessive economic growth.

Central banks are especially alert to economic circumstances that are likely to lead to excessive inflation. The problem for the past decade, as the committee will be aware, is inadequate inflation. Most central banks have actual or implied inflation targets of around 2% per annum. Generally, current rates (with wide variation in emerging markets) are below that level and likely to remain so. The exception of course amongst the western economies is the UK - where the Brexit inspired depreciation of sterling has caused a temporary surge in inflation to around 3%. So, inflation in a global context is unlikely to be a problem in 2018.

So why the caution about markets?

The principal reason for caution is the magnitude and duration of the bull market in equities. Is this – in itself – a sufficient reason to trigger a bear market? No. But the surge in share prices in recent years has been phenomenal. In round figures, the US market rose 25% in 2017, Germany and France around 15%, with the UK, despite legitimate Brexit anxieties, the laggard at 10%. Nothing rises forever – as the old stock market adage goes. The longer term picture shows the US equity market rising three fold since early 2009, i.e. a period of some 9 years. This duration is not quite without historical precedent, but fast approaching it. Other major equity markets exhibit similar, if less dramatic, patterns.

The committee will be well aware of the decisive influence that the global central banks (the US Federal Reserve, the Bank of England, the European Central Bank and the Bank of Japan, for example) have had over the global economy since the financial crisis of 2008/9. Their decisive cutting of interest rates and more especially of their purchase of prodigious amounts of government and other debt (known as Quantitative Easing) has flooded the world with cash and been the underlying reason for the surge in global stock markets. The rise has largely been a monetary phenomenon – but not entirely. Company earnings have grown strongly in this decade and will continue to do so in 2018.

What triggers a decisive fall in markets?

In global terms, that is usually an economy that is overheating and likely to stimulate inflation rising to levels that are unacceptable to central banks. Their response would be to raise interest rates with a view to slowing economic growth – with the risk that their actions could result in a recession. As we have seen, such a trigger does not seem likely in 2018 because of the "goldilocks" scenario.

Apart from the magnitude and duration of the global equity bull market, it is difficult to see where the trigger lies. Anxiety amongst professional investors perhaps rests in the outlook for Quantitative Easing ("QE"). Two central banks have started to raise short term interest rates (the US Fed four times and the Bank of England only once) and both have been talking about withdrawing QE (i.e. selling off bonds), but have not yet started. In contrast, the European Central Bank and the Bank of Japan are continuing with their programmes and continue to buy bonds to enhance liquidity in their economies. In aggregate, the amount of bonds currently being purchased globally – for this is a global phenomenon – is still increasing. The global stock of bonds held by all the central banks could well peak in 2018 and then start to fall. But any decline will be very modest – as central banks embark very cautiously on their objective of returning the world to a measure of "normality".

Political worries are never far away, but few are of sufficient magnitude to have global implications. The obvious one is North Korea, and maybe the shenanigans of President Trump. Brexit is a European problem only.

Amount of speculation

The level of speculation present in a market is often taken as an indication of whether a market is close to a high or low point. Often, at a low point, speculation is almost entirely absent – few people have sufficient confidence to take the risk with funds. Conversely, there is often abundant speculation close to market peaks. Just now, the feature is not speculation in equities but in bitcoin and similar digital currencies – which is very high. Whether this is actually speculation by those who would otherwise dabble in equity markets or money laundering by the criminal fraternity is not clear.

Conclusion

Economic conditions globally remain benign. The markets continue their climb of the "wall of worry" with no obvious trigger point that could bring about the genesis of a fully-fledged bear market. But the risks are clearly rising. It is one thing to forecast that a market is close to a peak – quite another to identify the timing of a turning point. The latter usually defies analysis. So, remaining fully invested is still the right course of action for the Lincolnshire Pension Scheme.

Peter Jones
20th December 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

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

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