Lincolnshire COUNTY COUNCIL Working for a better future

Regulatory and Other Committee

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

Report to:	**Pensions Committee**
Date:	**03 October 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 – October 2019

Global economic recession? The risk is rising

Recent market movements

Markets in the summer months, especially in August, are often thinly traded and prone to significant moves. This year was no exception. Equities fell sharply in early August: by about 5% in the USA and rather more in Europe and elsewhere. They have since traded sideways and now seem to have formed a “base” from which, in September, they could advance. The surprising move, though, was in bond markets. The yield on the 10 Year US Treasury Bond (the largest and most liquid in the world) fell in August from around 2% to 1.5%. This may not sound much but is highly significant to professional investors. The conclusion that some participants are drawing is that they expect an economic recession in the USA, probably in 2020, and almost certainly therefore elsewhere in the world and especially in Europe. The UK gilt market experienced a similar fall in yields.

Economic trends

The volatility in equity markets in August was probably triggered by the continuing trade tensions between the USA and China. The negotiations show little sign of being brought to a mutually acceptable conclusion. The row has already led to a reduction in international trade. The expectation of many economists is that this reduction will lead to a fall in the domestic economic output of both the USA and

China. So far, it seems that USA is still growing at about 2% per annum and China at maybe 5% plus. Historically, these are not stellar rates, but they are respectable. Elsewhere though, there is certainly a negative effect on emerging markets. Parts of Europe are already experiencing recessionary conditions, most notably Germany (heavily reliant on its export of cars and machinery) and in Italy. It is not difficult see the UK falling into recession. The second quarter saw a mild contraction because of de-stocking, following the aborted withdrawal by the UK from the EU at the end of March. Early indications for the third quarter, ending in September, are for a significant fall in output. A figure as high as 2% has been mooted. This would certainly cause anxiety amongst equity investors and support the global bond markets at these low current yields.

Politics

And the summer has been notable for political turmoil almost everywhere around the world. The trade tensions between the USA and China have already been mentioned. The Brexit shenanigans are familiar to every committee member. There is the continuing unrest in Hong Kong and a range of minority governments struggling to impose their will on their legislatures, e.g. UK, Germany and Spain. So politics are hardly supportive of equity markets and raises the attraction of safer bond markets.

Central Banks

Waiting quietly in the wings are the world's central banks. They have, almost without exception, indicated their willingness to ease monetary conditions and to reduce interest rates in an effort to support their respective economies. The economic data have not yet been sufficiently bad to warrant an intervention. Of more importance, however, is whether such moves could be effective in providing economic stimulus. Short term interest rates are so low that many investors and economists have their doubts, which I share. It is inconceivable that the kind of central bank interventions at the time of the global financial crisis some ten years ago could produce such a large stimulating effect.

Prospects

Yields on government bonds are now so low (many are on negative yields, e.g. Germany and Japan) that it is difficult to see a major part of institutional cash flows invested there. The only other markets with deep liquidity are global equities. The jitters by such investors in early August has passed, at least for now. I think equity markets will therefore trade sideways to up. As ever, significant falls will bring in "cheap" buyers. All this is predicated on the belief that central banks will "ride to the rescue" if there is a significant deterioration in the global economy. I am sure they will. The much more important question, in the medium term, is how equity markets react if they see that central bank actions are ineffective in boosting their respective economies. Then, the potential for a sharp fall in equities is quite likely - if not probable. The trigger for that might well be the worsening health of the global clearing banks.

Conclusion
Peter Jones

9 September 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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