Lincolnshire COUNTY COUNCIL
Working for a better future

| Open Report on behalf of Andrew Crookham, Executive Director - Resources |
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| Report to: | **Pensions Committee** |
| Date: | **14 October 2021** |
| 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**

**<u>Investment Commentary – October 2021</u>**

**Clouds gathering on the Economic Horizon? Stock markets, so far, seem oblivious.**

As autumn approaches, the economic clouds are darkening in most developed economies of the northern hemisphere. Growth rates of output are losing momentum and inflation rates are still rising in most, but not all, countries. No economic collapse is yet forecast. But the certainty about prospects of a steady recovery from the Covid-19 pandemic (with which investors have viewed the world for most of this year) is certainly ebbing away, to be replaced by more uncertain times. How will markets – both equities and bonds – react?

**Supply shortages and inflationary impact**

Committee members will be familiar with media reports of empty supermarket shelves, of shortages of lorry drivers and general problems with the global supply chain of goods to the developed world. Job vacancies have also risen sharply and many companies report major difficulties in recruitment of staff. The latest such anxiety is over gas supplies, where there is a global shortage – exacerbated by insufficient tanker and pipeline capacity to quickly remedy the situation. An immediate result is a sharp rise in other energy prices such as electricity. The consequence of an insufficient supply of any such product is obviously the ability of providers to push prices higher. In other words, an attempt to ration supplies by price rises rather than physical control.

This increase in prices generally has been evident for some months now in published inflation data. Up until now, the major Central Banks of the world (e.g. the Bank of England, US Federal Reserve, the European Central Bank) have been resolute in arguing that the rise in inflation was a short term phenomenon and did not require remedial action from them, for example, by a rise in short term interest rates. Recent inflation numbers have been modest by long term historical standards (under 6% recently in the USA and under 5% for example in the UK and Germany) and there have been signs of them reaching a peak in the near future. A key component of the rise in inflation globally has been the amazing rise in second hand car prices because of a dearth of new vehicle supply caused by shortages of essential computer chips. These increases in second hand prices were as high as 15%; they may now be easing back a little. So, investors – and investors in bonds in particular – have generally agreed with the views of the central bankers that the rise in inflation was a temporary phenomenon. The major central bankers have all talked about their intention to raise short term interest rates in the future – but have held back from actually doing so. Now that a sharp rise in energy prices is almost certain as the northern hemisphere winter approaches, will this consensus still hold?

**Squeeze on living standards**

It is an old adage that a rise in energy prices acts as a tax increase (because of the unavoidable effects on us all through the costs of heating, fuel costs for our cars and transport costs in the goods that we buy). If these rises are to be accompanied by tax increases to pay for the costs that governments incurred during Covid, then the impact on ordinary people could be severe. So, in the UK at least, the economy could face a pretty drastic impact on living standards, especially for the lower paid. I hesitate to use the word "stagflation" i.e. no economic growth but an uncomfortably high level of price inflation, but I no longer think it is impossible. I doubt that other developed economies will be immune from such a tendency.

**Stock market prospects**

So far, global equity markets have remained firm. Cash flows into the coffers of institutional investors remain strong. The US equity market has risen some 5% across the summer, and most others are up modestly. The UK market has lagged. Bond markets have traded pretty much sideways - with yields remaining very low. And therein lies investors' dilemma. If bonds are unattractive (and that view is certainly widely held) what are the easily investible alternatives? The short answer is only equities. They can be freely traded, in large size, in contrast to most other investments.

If the equity markets are to weaken materially, then such a movement often starts with the "bears" shorting stock that they do not own, with a view to buying it back at lower prices. Such bears have been absent from markets for most of 2021. Daily falls in equity indices of say 2% are not uncommon in most years. They have been in 2021. A global economic crisis could certainly put equities into a tailspin. The huge increase in global gas

prices may have the potential to do so – but has not so far. For the time being, the mantra "there is no alternative" to equities still holds.

Peter Jones
26 September 2021

**Consultation**

**a) Risks and Impact Analysis**

The Pension Fund has a risk register which can be obtained by contacting the Head of Pensions.

**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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