Lincolnshire COUNTY COUNCIL *Working for a better future*

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

Report to:	**Pensions Committee**
Date:	**16 December 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

Investment Commentary – December 2021

Still few practical alternatives to investing in global equities

The Committee last met in mid-October and we had a full discussion about the global equity and bond markets and their potential for significant price falls – unless there was continued financial support from the world's Central Banks. We touched on the markets' potential vulnerability to higher than anticipated inflation.

What financial parameters have changed?

Certainly, the inflation numbers as measured by the various consumer price indices around the world have worsened, notably in the USA, UK and Europe. Most major economies have been less buoyant in terms of economic growth (i.e. in output) than previously anticipated; but probably not materially so. And forecast economic growth rates in 2022 have been scaled back somewhat. The well known supply chain difficulties have not improved and anxiety about timely deliveries to consumers and business alike continue. There is little optimism about an improvement before the Christmas Holiday in the western world or before Chinese New Year in Asia. The Covid situation was already worsening in some countries, notably Austria and Germany, before the alarming news of the new Omicron Covid variant was discovered in South Africa. The Northern Hemisphere

winter is expected to see the Covid position deteriorate more widely, with the potential for a "knock on" effect on the supply chain and thus on higher price inflation.

Central Bank actions and inflation prospects

There is little doubt that the publication of recent inflation numbers had the potential to "panic" equity markets and cause a sell off. But they did not. Perhaps, for two reasons. Many investors (perhaps a majority?) still regard high inflation as temporary and strongly related to the supply chain problems. Once the latter return to normal – say in the second quarter of 2022 – inflation should subside to more normal levels. Other investors do not share such a view and regard current levels as a new norm. So far, few Central Banks have been provoked into taking significant financial initiatives to combat inflation by tightening financial policies: i.e. reducing their financial support for markets. In particular, the US Federal Reserve (the US Central Bank) has so far been sitting on its hands and talking about the need for action in the future. In the past couple of days, Jerome Powell, the Chairman of the Federal Reserve, in response to a question from a Congressman, said that the FED's belief that high inflation was "transitory" might need review. It is not clear exactly what this means in terms of action to tighten financial conditions. In contrast, the Governor of the Bank of England has talked openly about imminent action. But none has yet been forthcoming – perhaps hoping that "talk talk" will do the tightening for it by increasing market related interest rates? But, it would seem perverse to take action to reduced financial support before the harmful effects (or otherwise) of the Omicron variant have been properly evaluated. As ever with Central Banks, watch their actions – and not their pronouncements!

Equity and bond market performance

Since we last met in mid October, markets are little changed in aggregate. All equity markets were somewhat higher until mid November, but then fell sharply across the Thanksgiving Day weekend on the disclosure of the Omicron variant and the fears raised by it about continuing supply chain problems and hence anxiety about future inflation. Only the US equity market made a net gain over the period. Bond markets had a sell off during November, taking yields higher worldwide on inflation fears, but have largely retraced their price falls subsequently.

Conclusion

At the time of writing, it is too soon to assess the severity of the Omicron virus. How virulent is it – and how effective are current vaccines? So the potential for significant price falls in equities, and possible gains in bond prices, certainly exists. Absent those worst fears, bond yields still seem to me to be unattractive to a pension scheme with liabilities similar to Lincolnshire's. So, I see no practical alternative to global equities for significant flows of new investment funds.

Peter Jones
6 December 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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