Lincolnshire COUNTY COUNCIL
Working for a better future

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

Report to:	**Pensions Committee**
Date:	**22 September 2022**
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 discuss the report and consider whether any further information is required.

Background

<u>Investment Commentary – September 2022</u>

A gloomy economic winter in prospect – but markets remain cheerful

This winter is going to very difficult financially for both private individuals as consumers and for the corporate sector as suppliers – both in the UK and in Europe. In Europe, its economy is already contracting i.e. falling into recession and the UK seems to be stagnating but may soon follow suit. The USA is still growing economically. The direct cause of these troubles is, of course, the shortage of energy and the price at which it is available on world markets. But supply chain shortages as a result of covid, the uncertainty generated by the war in Ukraine (which seems close to stalemate) and the worsening relationship between the USA and China are contributory factors. Inflation, worldwide, has reached levels (generally around 10%) that would have seemed unimaginable not many months ago.

Yet stock markets have had a good summer, rising between 5% and 10% from their respective June lows. The FTSE 100 index of the UK equity market for example, is now within 5% of its all time high reached in January this year – though other world markets have not done as well. All of which seems at odds with near term economic and financial prospects this winter.

Central Banks and stagflation

Faced with rising inflation – indeed runaway inflation currently – Central Banks have a mandate to take action. First, to stop it rising further, and secondly to bring it down to acceptable levels. In recent years, most Central Banks have targeted 2% as such a level. With inflation currently around 10% in many parts of the globe, that is a daunting prospect. Their traditional response is to raise interest rates (Base Rate in the UK, Fed Funds Rate in the US) and this is already underway. But what elevated level will be required to achieve such targets? And for what length of time? Almost certainly well into 2023.

Consider the plight of the UK consumer. All of us in the UK, not only those less well off, face enormous increases in their energy bills this winter and into next year. At the same time, grocery bills are rising sharply as are many other essentials such as fuel for our cars. If mortgage interest rates, which are tied to base rate, also rise the squeeze on other freely available cash will be considerable. Not only is it the reduction in disposable income that needs to be contended with – but the considerable uncertainty about being unable to estimate financial circumstances in as little as six months time. Unemployment is currently very low, but the financial squeeze on the company sector could see this edge up. Of, course, widespread financial support from the UK government must and will be forthcoming – but to what extent, and when, is presently (late August) uncertain. All of which, leads me to re-iterate that a recession in the UK seems very likely.

If it a consolation, (and I do not think it is) Europe is in a worse predicament. Its economy will have a very troubled winter given its previous heavy reliance on Russian oil and gas. Power blackouts are almost certain. And its heavy industries, steel, chemicals etc are in dire difficulties. The USA is in a much better position, being self-sufficient in energy: energy prices are a great deal lower than in Europe. China has its own woes, stemming from its failure to deal expeditiously with its covid epidemic earlier this year. It is not clear when China can return to its previous economic growth rate of say 5%. Its export markets are receding and shortages of global shipping capacity for its exports remain.

Stock markets

Is all this too gloomy? Markets seem to think so. Seemingly, there is a “dis-connect” between our personal financial prospects and stock markets. Yet the cash flows of institutional investors, as ever, remain paramount in understanding the prospects in the months ahead. These remain strong. If a stock market fall does happen, I suspect it might well be limited, unless a global recession is in prospect.

Conclusion

Peter Jones
2 September 2022

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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