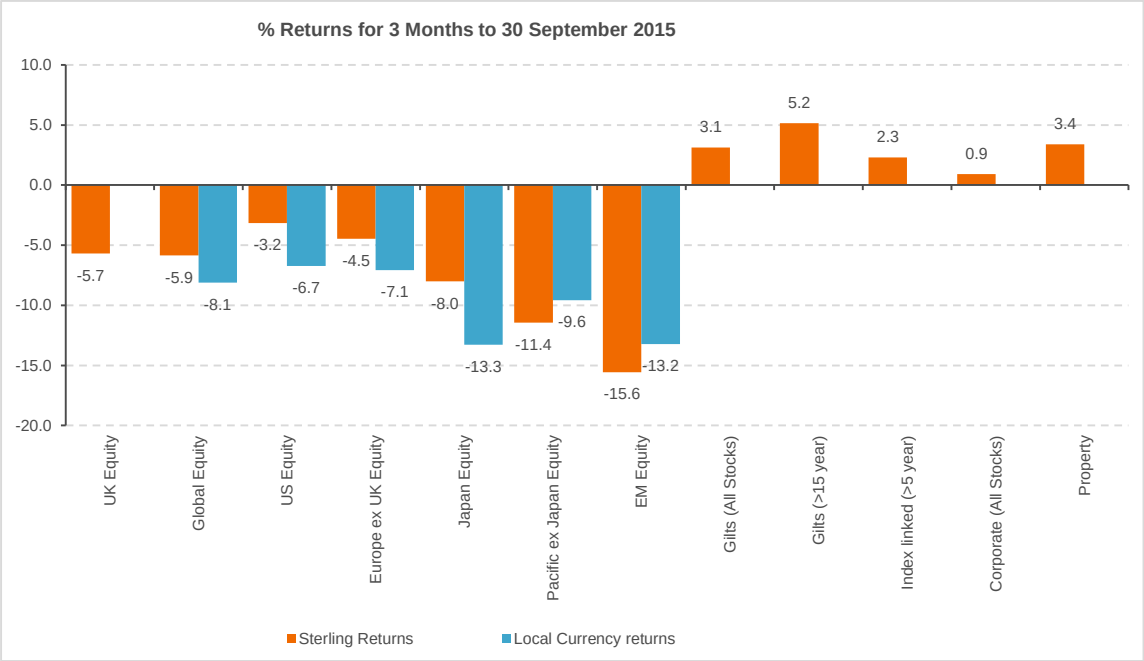
Market Background

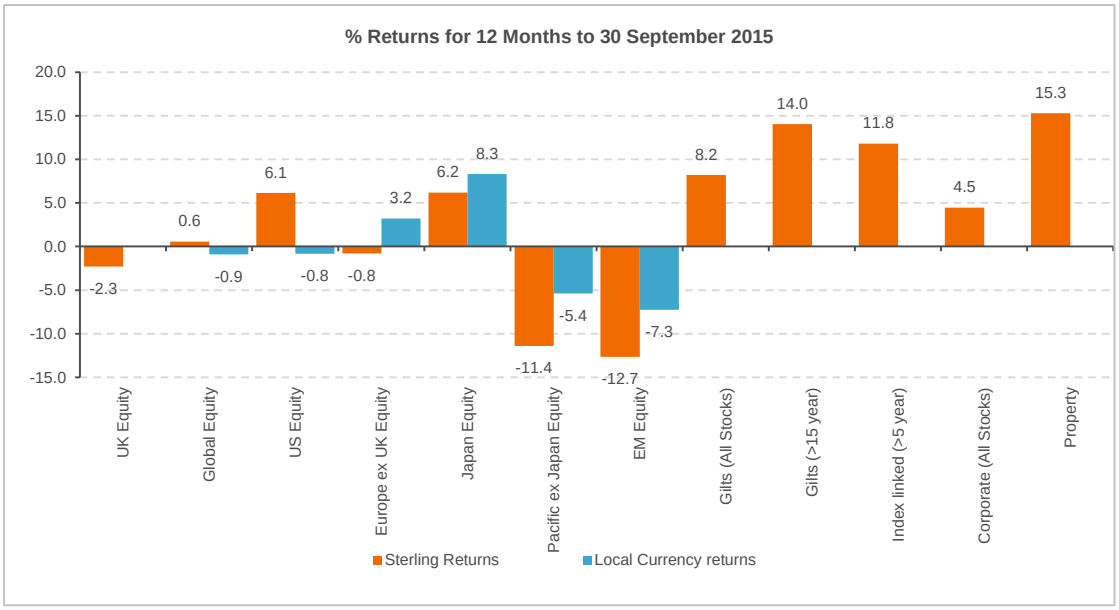
Introduction

This paper, addressed to the Pensions Committee of the Suffolk County Council Pension Fund ('the Fund'), discusses the market background over the third quarter of 2015.

Market Background

The following chart shows the market returns over periods to 30 September 2015:





Source: Datastream

Market review – Q3 2015

Global equity markets recorded their worst three month returns in four years. In the UK the FTSE All Share index fell by 5.7%; in the US, the S&P 500 index fell by 4.1%. August was a particularly difficult month, with global equities falling by more than 5% and government bonds offering little in the way of a safe haven.

The economic slowdown in China dominated the headlines during the quarter, with the country's economy growing at its slowest rate in over six years. In August, the benchmark interest rate was cut for the fifth time since November 2014.

An increase in short-term interest rates in the US had been widely anticipated at the start of the quarter, but developments in China shifted expectations. Many commentators are now anticipating that the first US rate rise will be pushed into 2016. However, the US economy continued to be robust, with falling unemployment and upward revisions to growth forecasts. The chairman of the Federal Reserve suggested, at the end of the quarter, that a US rate rise was still likely before the end of 2015.

Key events during the quarter included;

Global Economy

- Short-term interest rates were unchanged in the UK, US, Eurozone and Japan;
- Headline inflation in the US, Eurozone and UK remained close to zero;
- The VIX volatility index spiked as equity markets fell, peaking at more than double its historic average since 1990;
- Oil prices slid back to their lows of early 2015, dipping under $50 per barrel;
- Commodity prices suffered their biggest quarterly decline since 2008.

Equities

- The strongest sectors relative to the FTSE All World Index were Utilities (+7.6%) and Consumer Services (+5.1%); the weakest were Basic Materials (-11.4%) and Oil & Gas (-9.9%);
- Emerging market equities struggled; local currency weakness compounded the falls for UK investors.

Bonds and currencies

- Sterling fell against the Dollar, Euro and Yen, largely reversing gains made during the preceding quarter;
- UK gilt yields fell (prices rose), with nominal yields falling further than real yields

The tables below provide a summary of key financial indicators over recent periods:

	31.12.2012	31.12.2013	31.12.2014	30.06.2015	30.09.2015
UK Equity Yield	3.6%	3.3%	3.4%	3.5%	3.7%
UK Equity P/E Ratio	12.3	14.9	15.8	15.1	17.1
Over 15 year gilt yield (p.a.)	3.0%	3.6%	2.4%	2.6%	2.4%
Over 5 year index-linked gilt yield (p.a.)	-0.1%	0.1%	-0.8%	-0.8%	-0.8%
iBoxx Over 10 year Non-gilt yield (p.a.)	4.1%	4.6%	3.6%	3.8%	3.8%

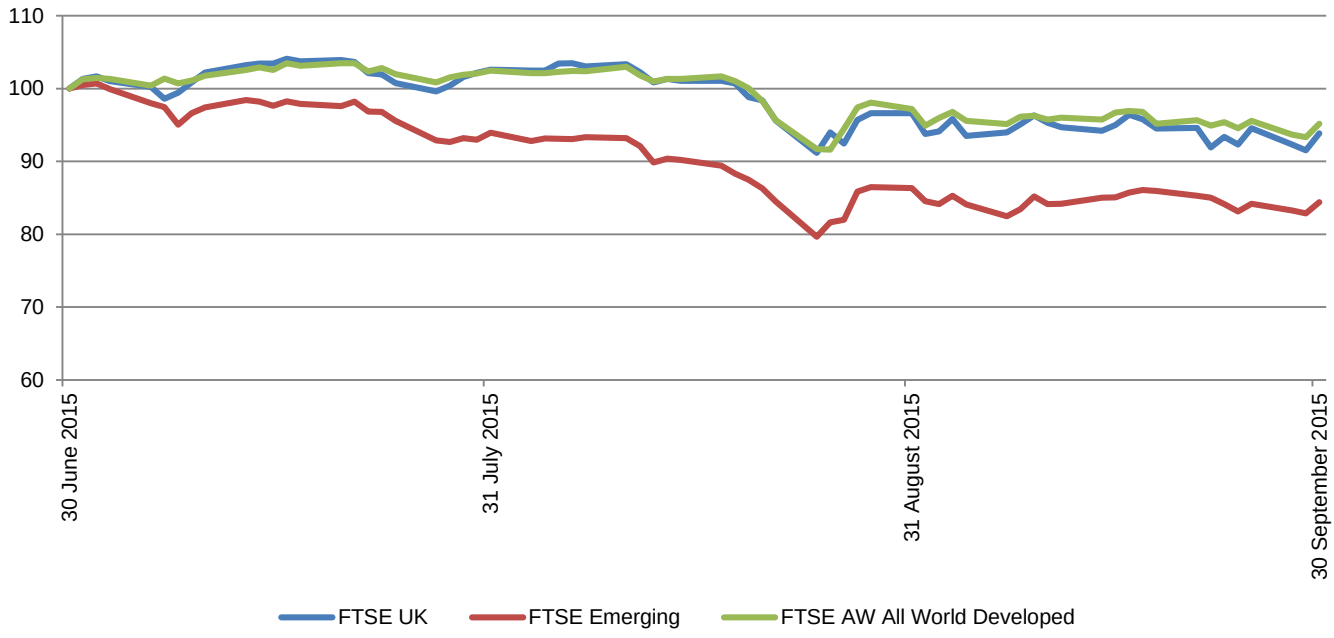
Equities

Global equity markets performed negatively over the quarter, in large part due to a risk-off environment towards the end of August. When translated to sterling, they returned -5.8% over Q3 (as measured by the FTSE All World index). No major region performed positively in sterling or local currency terms.

Over the quarter, the strongest sectors relative to the FTSE All World Index were Utilities (+7.6%) and Consumer Services (+5.1%); the weakest were Basic Materials (-11.4%) and Oil & Gas (-9.9%).

The following chart plots the performance of the global equity market since the end of Q2 2015.

Chart 1: Global equity markets to 30 September 2015



Source: Datastream

Fixed Income

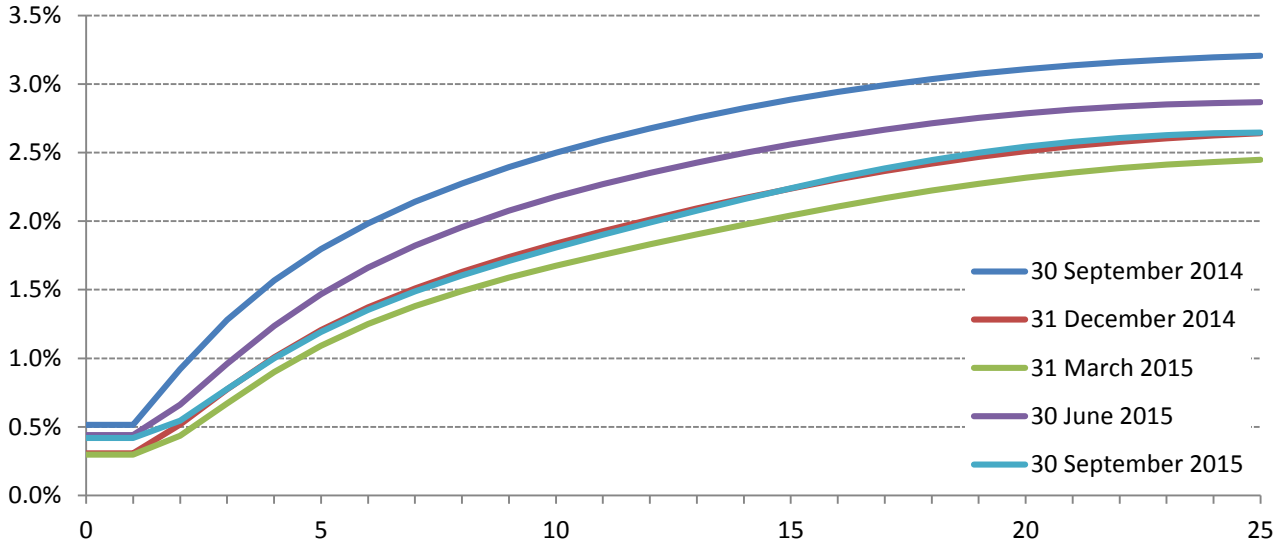
Short term inflation has fallen in recent months, driven primarily by falling oil prices. Long term inflation expectations have also fallen as a result.

Chart 2: Long term implied inflation

Source: Datastream

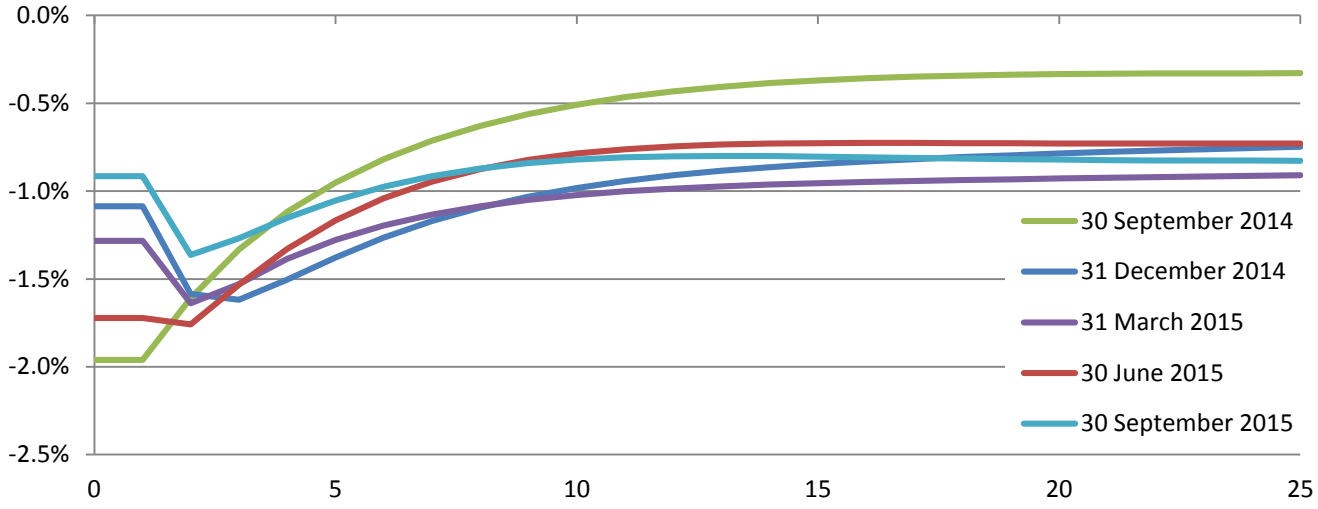
Bonds posted positive returns during the quarter. The All-Gilts index was up 3.1% while long-dated gilts returned 5.1%. The >5yr Index Linked index returned 2.3% over the quarter. All three indices have posted strong, positive returns over the past 12 months.

Chart 3: Nominal gilt yields



Source: Datastream

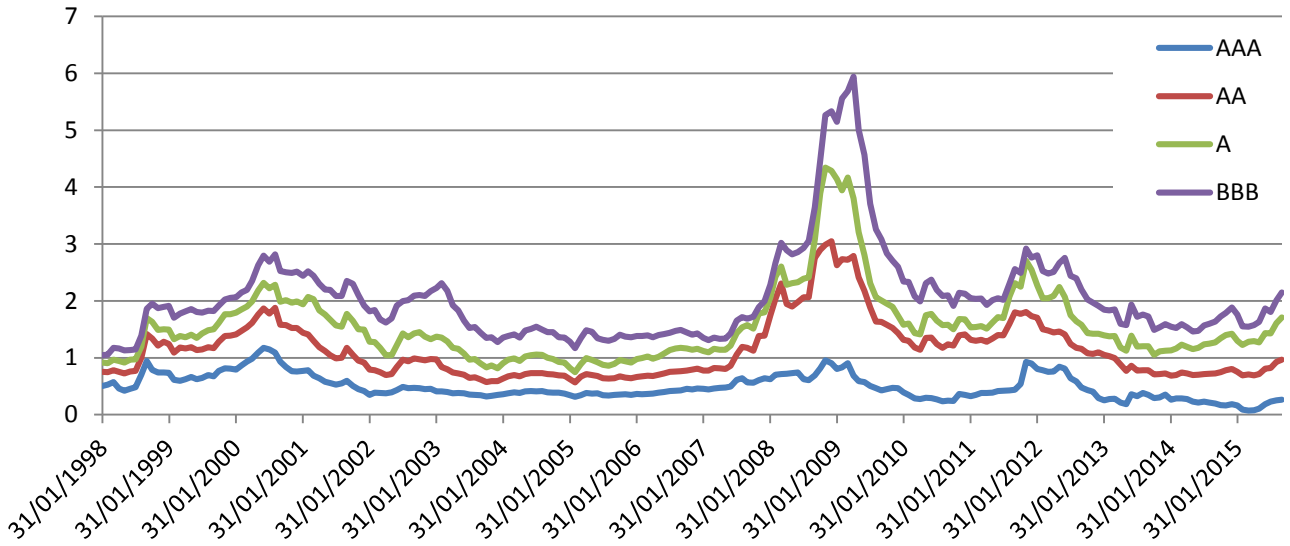
Chart 4: Real gilt yields



Source: Bank of England

Corporate bonds underperformed gilts over the quarter (0.5% vs 3.1%) as spreads widened. Credit has also lagged gilts over the 12 month period (3.9% vs 8.2%).

Chart 5: Corporate bond yield spreads over gilts (% p.a.)

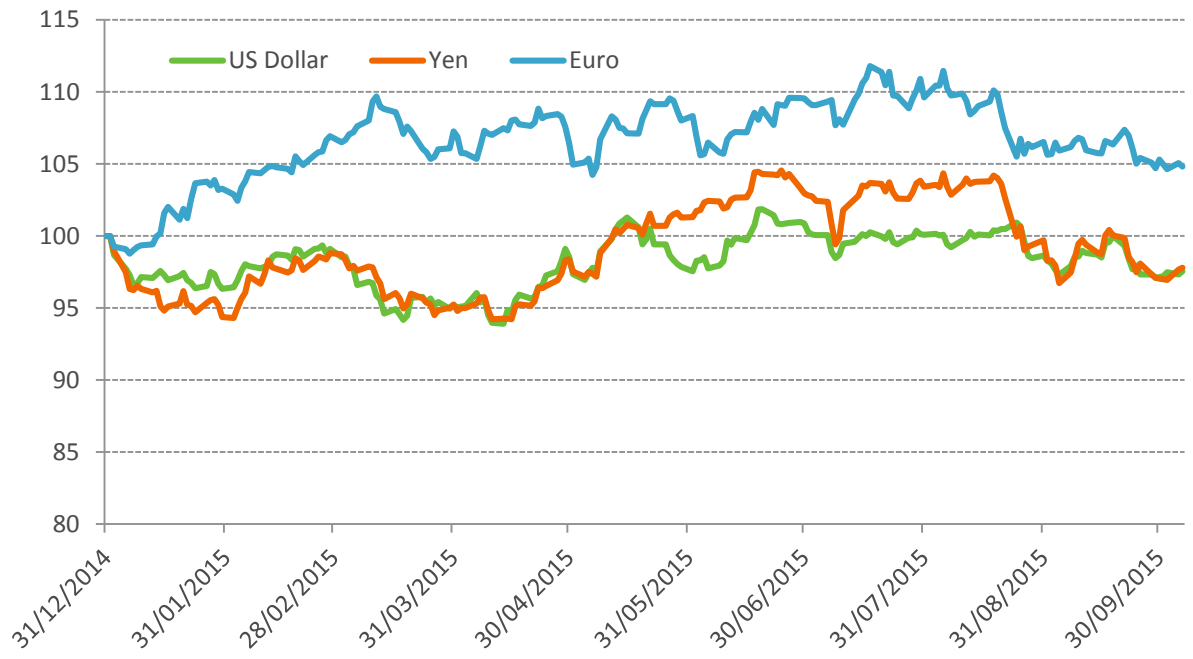


Source: Datastream

Currency

Over the third quarter of 2015, Sterling weakened against the Euro, Yen and Dollar, as expectations of interest rate rises in the UK were pushed back.

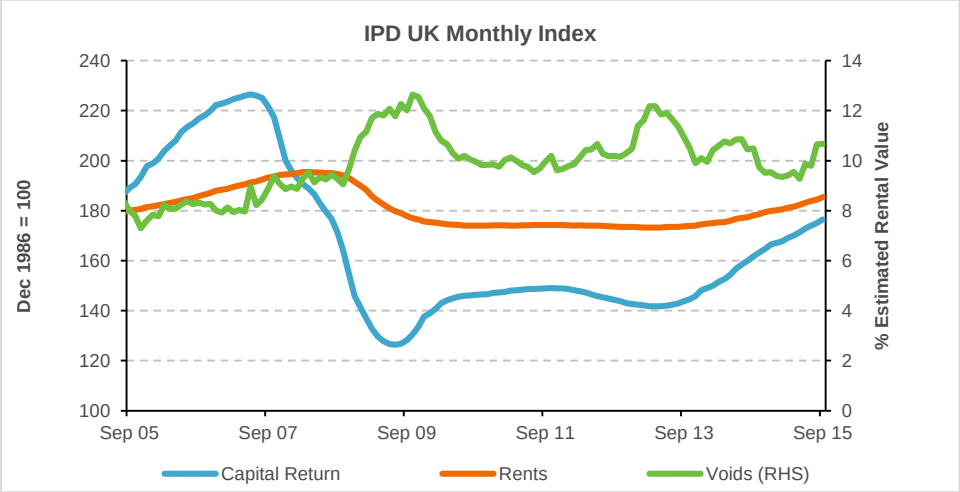
Chart 6: Sterling performance to 30 September 2015 (%)



Source: Datastream

Property

Property continued to perform strongly over the quarter. However, we are becoming more cautious as the majority of returns reflect capital growth rather than income growth and this may come under pressure in a rising interest rate environment.



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For and on behalf of Hymans Robertson LLP

General Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.