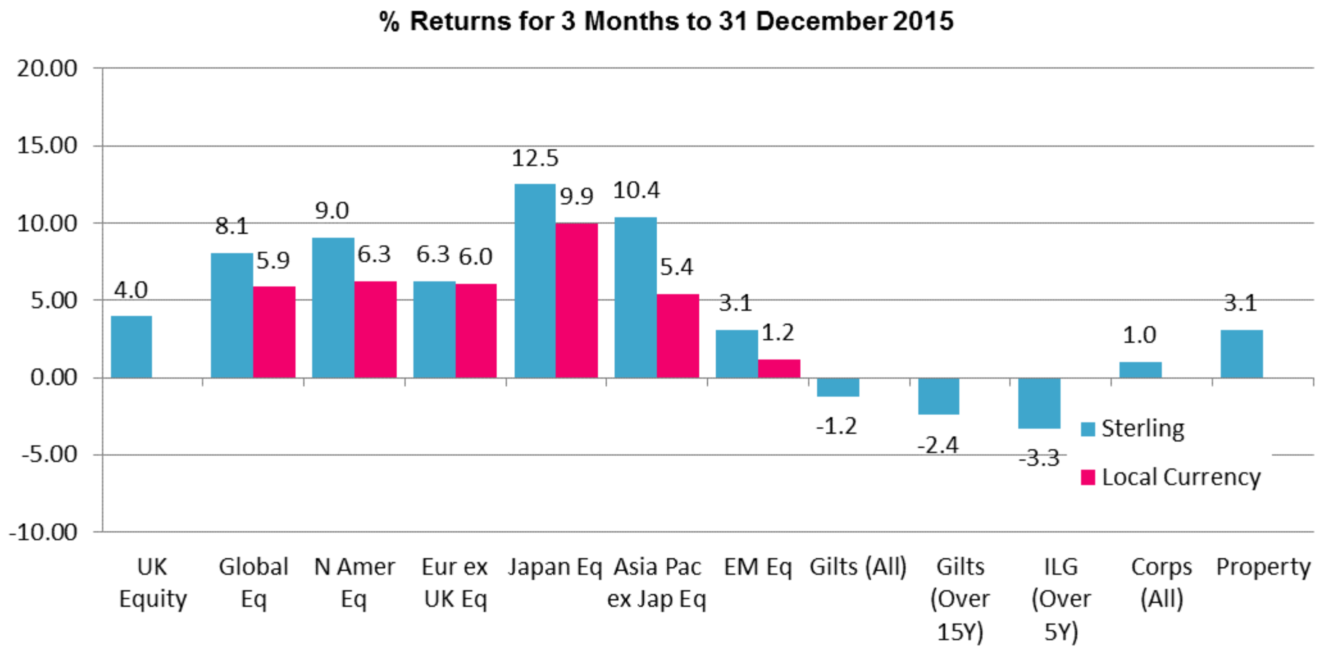
Market Background

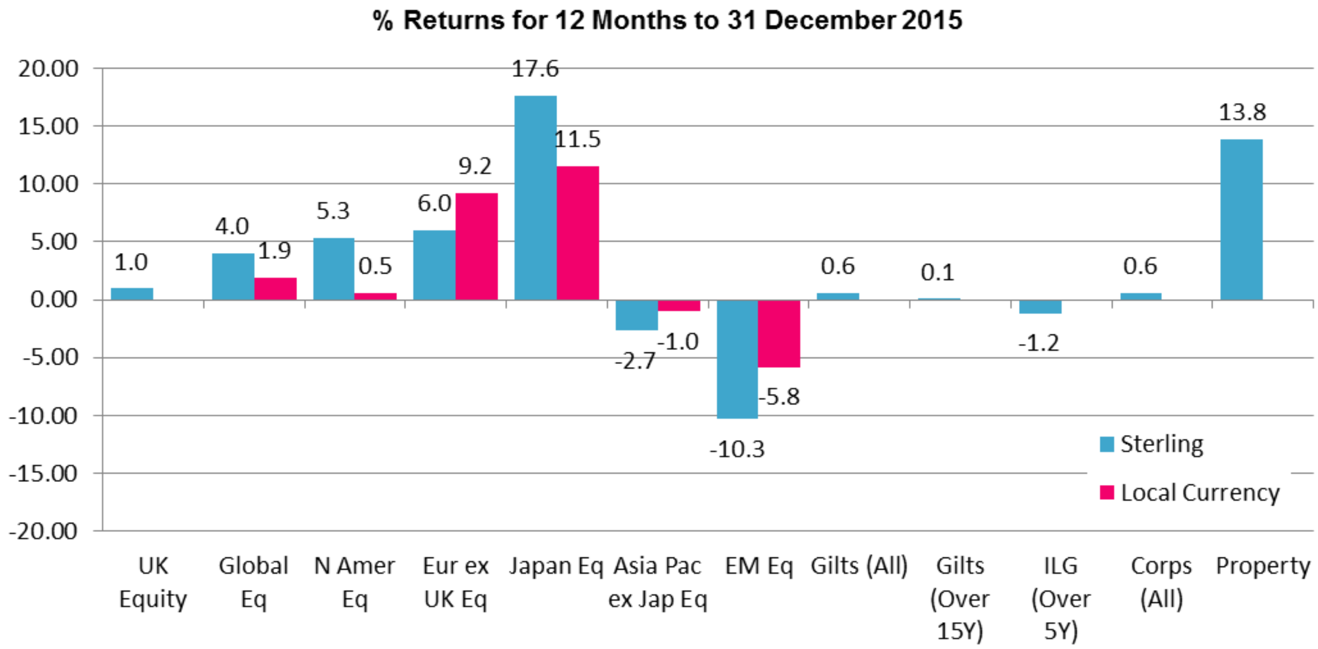
Introduction

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

Market Background

The following chart shows the market returns over periods to 31 December 2015:





Source: Datastream

Macroeconomic background

Global equity markets rebounded strongly from the setback of Q3, with the FTSE All World index returning 8.1%. In the UK the FTSE All Share index rose by 4.0%; in the US, the S&P 500 index increased by 10.0%. The defensive qualities of government bonds were in less demand and they delivered negative returns over the period.

Economic news was varied. The US and China appeared to be slowing, while Japan and Eurozone showed signs of improvement. There was no relief for oil exporting countries as oil prices fell to their lowest level in seven years. Brent crude finished the year just above $35 per barrel, less than one-third of its mid-2014 highs.

There was growing divergence in the policies of major central banks. In response to stubbornly low inflation, the European Central Bank extended its monthly €60bn quantitative easing programme by six months and cut its overnight deposit rate from -0.2% p.a. to -0.3% p.a. Many had expected more drastic measures. After almost a decade of no change, the Federal Reserve raised US interest rates from 0.25% p.a. to 0.50% p.a. Continuing labour market strength had made this all but inevitable and market reaction was muted. In the UK, the Bank of England hinted that a rise in UK interest rates was unlikely until much later this year.

Key events during the quarter included;

Global Economy

- December's rise in US interest rates was the first for nearly 10 years;
- In November's Inflation Report, the Bank of England indicated that UK interest rates were unlikely to rise until late 2016;
- Oil prices fell to their lowest levels in seven years, finishing the year just above $35 per barrel;
- Slowdown in the Chinese economy continued with GDP growth falling below 7% for the first time since 2009;
- Cyclical commodities such as industrial metals and energy have particularly suffered from China's slowdown;

Equities

- The strongest sectors relative to the FTSE All World Index were Technology (+3.2%) and Health Care (+2.0%); the weakest were Oil & Gas (-2.0%) and Utilities (-3.9%);
- Japan was the strongest performer during the quarter; while Emerging Markets were again the weakest.

Bonds and currencies

- Sterling was broadly flat against the Euro but weakened against the Dollar and Yen.
- UK gilts fell (yields rose) as equity markets rallied and investors switched to higher risk assets.

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

	31.12.11	31.12.12	31.12.13	31.12.14	30.09.15	31.12.15
UK Equity yield	3.5%	3.6%	3.3%	3.4%	3.7%	3.7%
UK Equity P/E ratio	10.6	12.3	14.9	15.8	17.1%	17.8%
Over 15 year gilt yield (p.a.)	2.9%	3.0%	3.6%	2.4%	2.4%	2.6%
>5 year index linked gilt yield (p.a.)	-0.2%	-0.1%	0.1%	-0.8%	-0.8%	-0.7%
iBoxx >10 year Non-gilt yield (p.a.)	4.9%	4.1%	4.6%	3.6%	3.8%	3.9%

	Year to 31.12.11	Year to 31.12.12	Year to 31.12.13	Year to 31.12.14	Year to 31.12.15	Quarter to 31.12.15	31.12.15 to 10.2.16
FTSE All Share	-3.5	12.3	20.8	1.2	1.0	4.0	-9.3
Global Equity	-6.6	12.0	21.0	11.3	4.0	8.1	-8.4
Over 15 year gilts	26.3	2.9	-5.9	26.1	0.1	-2.4	7.9
Over 5 year index linked gilts	23.3	0.5	0.6	21.4	-1.2	-3.3	6.2
All Stocks Non-Gilts	6.9	13.1	0.9	12.2	0.5	0.4	0.9
IPD Monthly Index	8.1	2.4	10.9	19.3	13.8	3.1	-

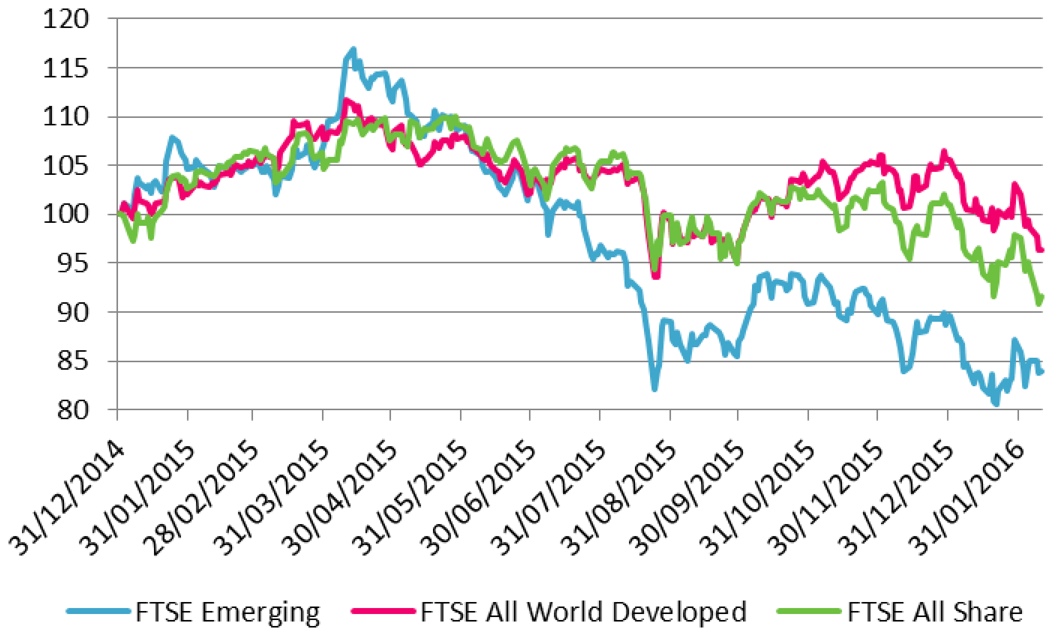
Equities

In sterling terms, global equities were down -5.8% over Q3 (as measured by the FTSE All World index). The weakest returns came from Emerging Markets (-15.6% in sterling terms) followed by Asia Pacific ex Japan (-11.4%). All other major markets (UK, North America, Europe ex UK and Japan) also posted negative returns (between -3.5% and -8.0% in sterling terms). In local currency terms, UK and North America were the least negative markets (-5.7% and -6.8%). Over the 12 month period ending 30 September 2015, the strongest returns (sterling denominated) came from Japanese equities (+6.2%) followed by North America (+4.6%). All other markets were negative over 12 months, UK equities returned -2.3%, Europe ex-UK -0.8%, Asia Pacific returned -11.4% and Emerging Markets -12.7%.

Over the quarter, the strongest sector return relative to the All World index came from Utilities (+7.6% relative). The weakest relative sector return came from Basic Materials (-11.4% relative). Over the 12 months, Consumer Services provided the strongest returns (at +14.8%), with Oil & Gas the weakest (-28.6%). Globally, value stocks underperformed growth over the quarter (-6.7% v -5.0%).

The following chart plots the performance of the global equity market since the end of Q4 2014.

Chart 1: Global equity markets

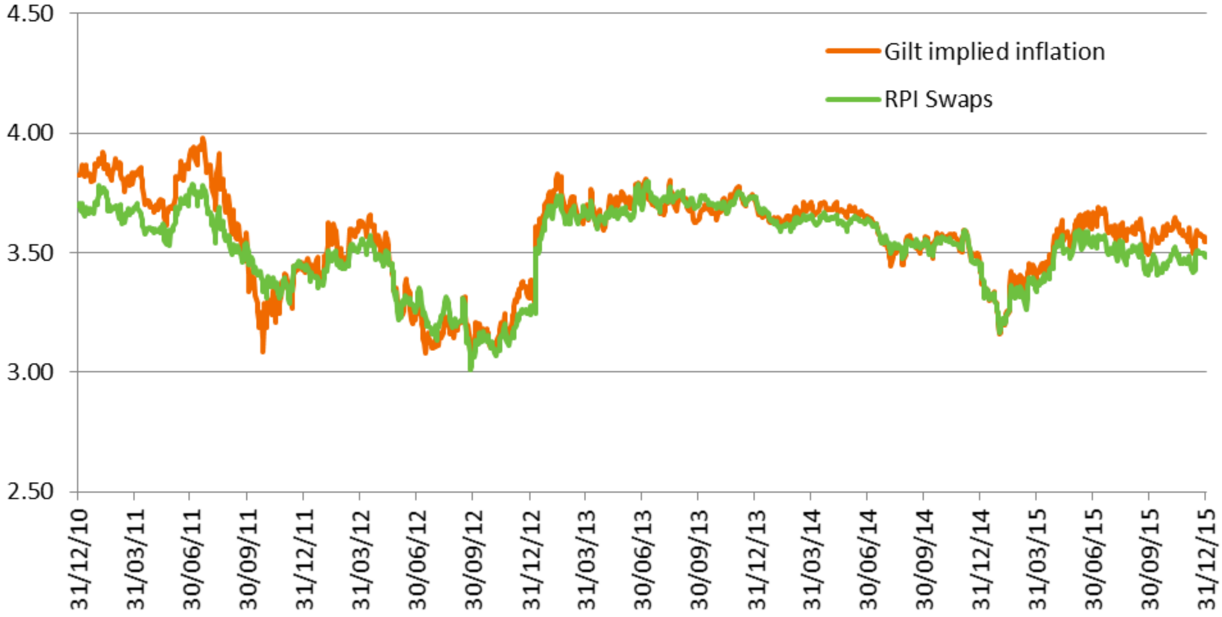


Source: Datastream

Fixed Income

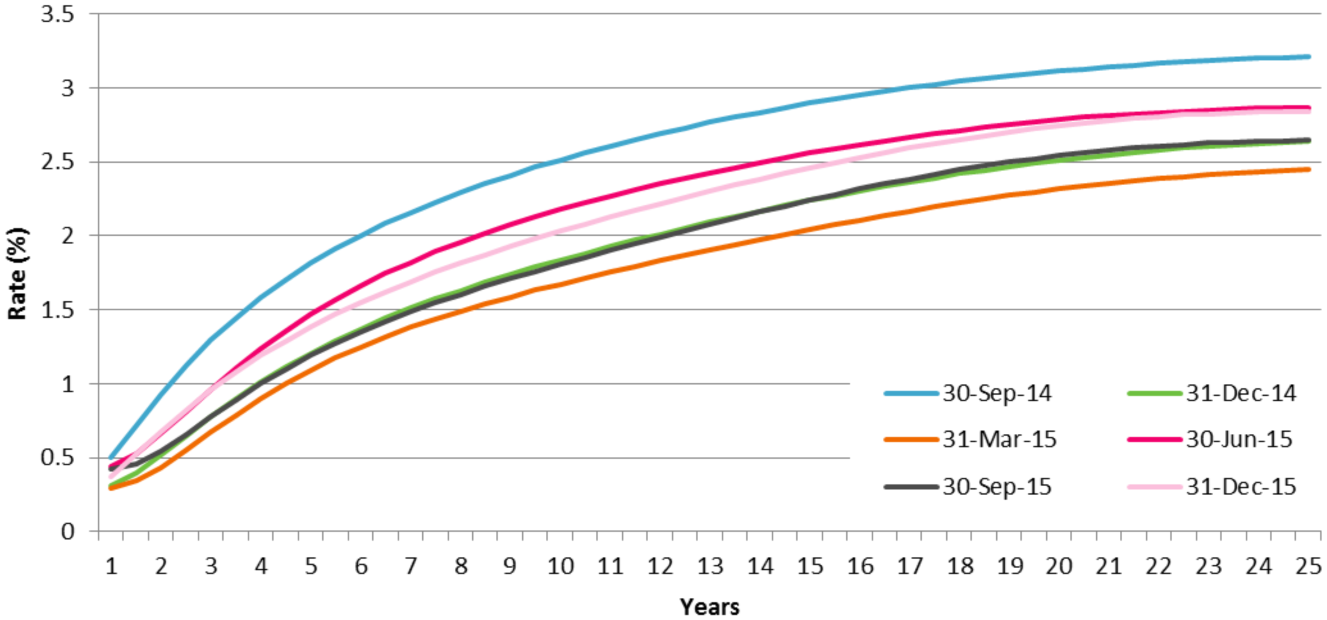
Long term inflation expectations have risen from a low point at the end of January 2015.

Chart 2: Long term implied inflation



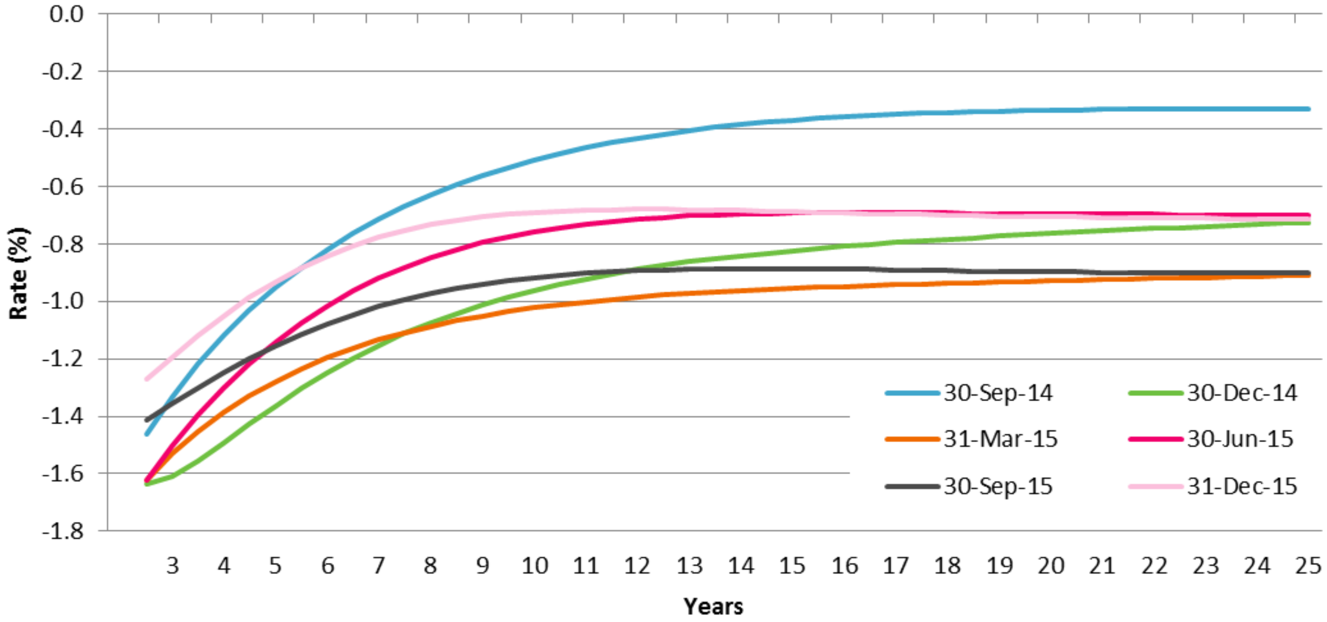
Prices of conventional gilts decreased over the quarter as yields rose, with the All-Gilts index returning -1.2% and the long-dated index returning -2.4%. Index-linked gilts also provided negative returns, with the >5yr Index Linked index returning -3.3%, as real yields rose. Over the 12 month period ending 31 December 2015, the All-Gilts index returned 0.6% and >5yr index-linked gilts delivered -1.2%.

Chart 3: Nominal gilt yields



Source: Bank of England

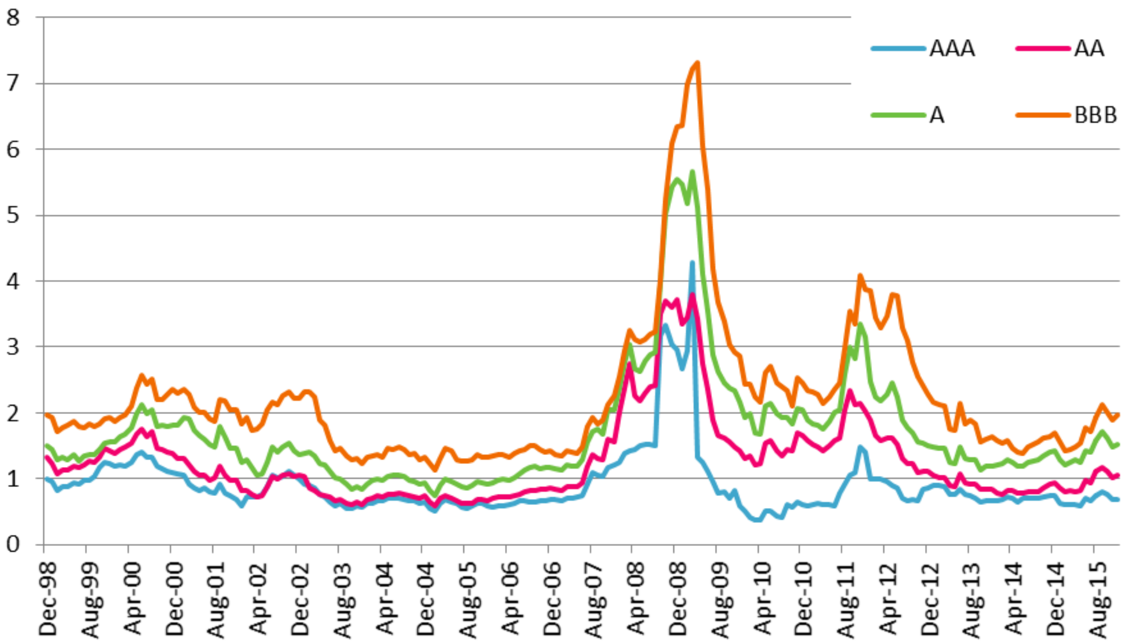
Chart 4: Real gilt yields



Source: Bank of England

Corporate bond prices outperformed gilts over the quarter (1.0% v -1.2%). The strongest area within corporates was the A and BBB issues (both 1.1%). Corporate bonds returned +0.6% over 12 months, with AAA-rated issues producing the strongest returns (+1.4%).

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

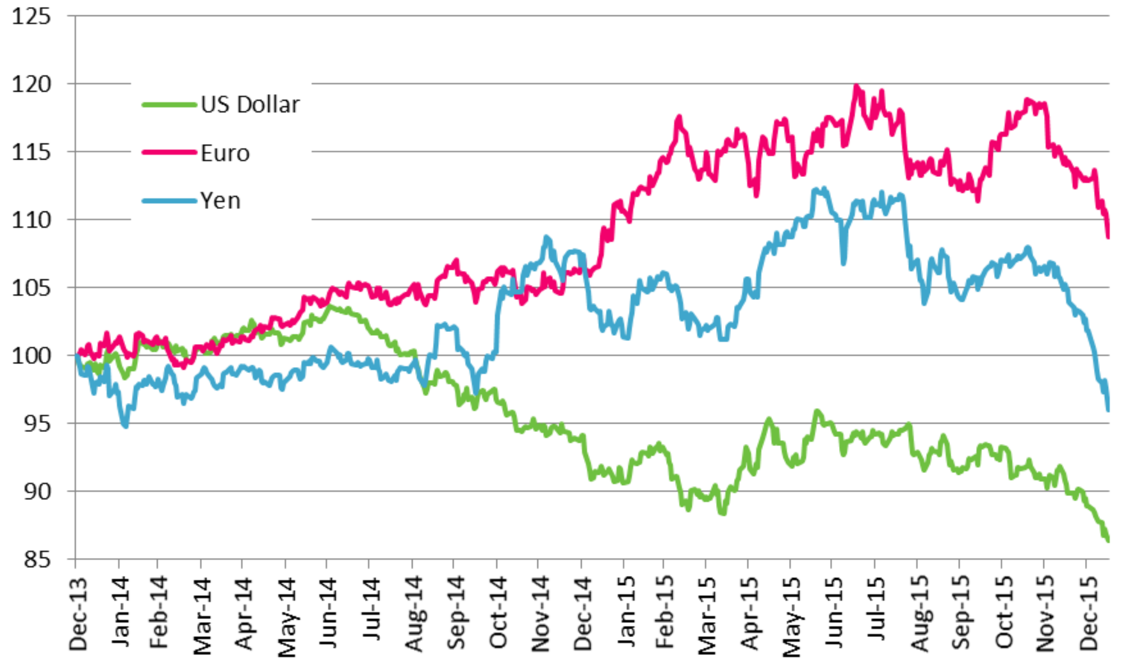


Source: Datastream

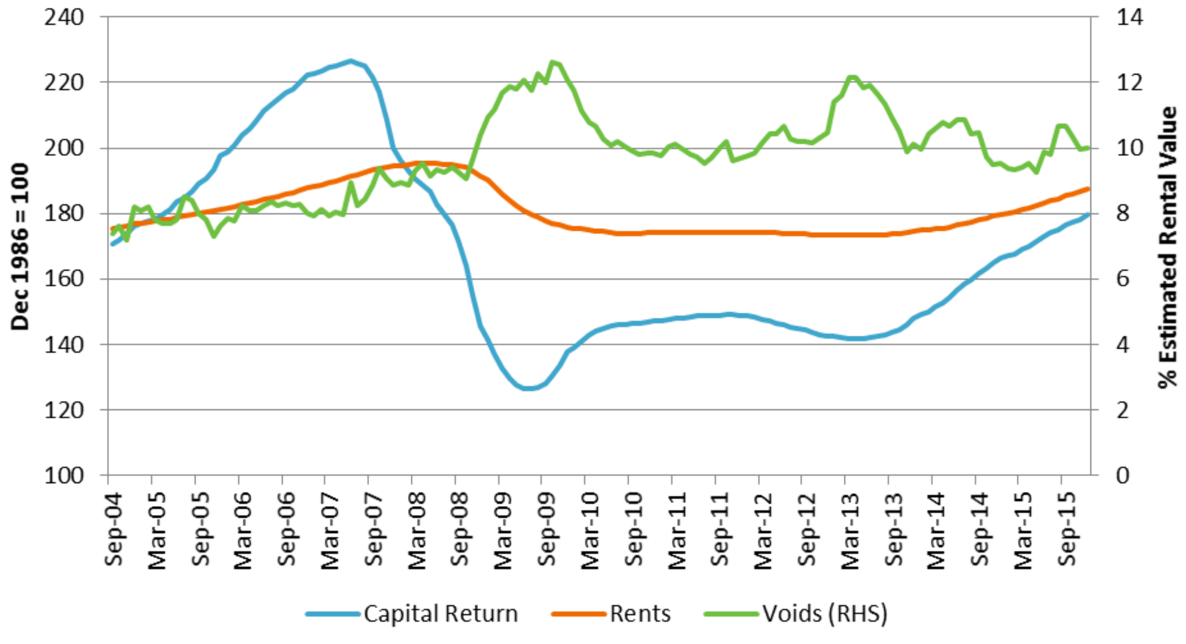
Currency

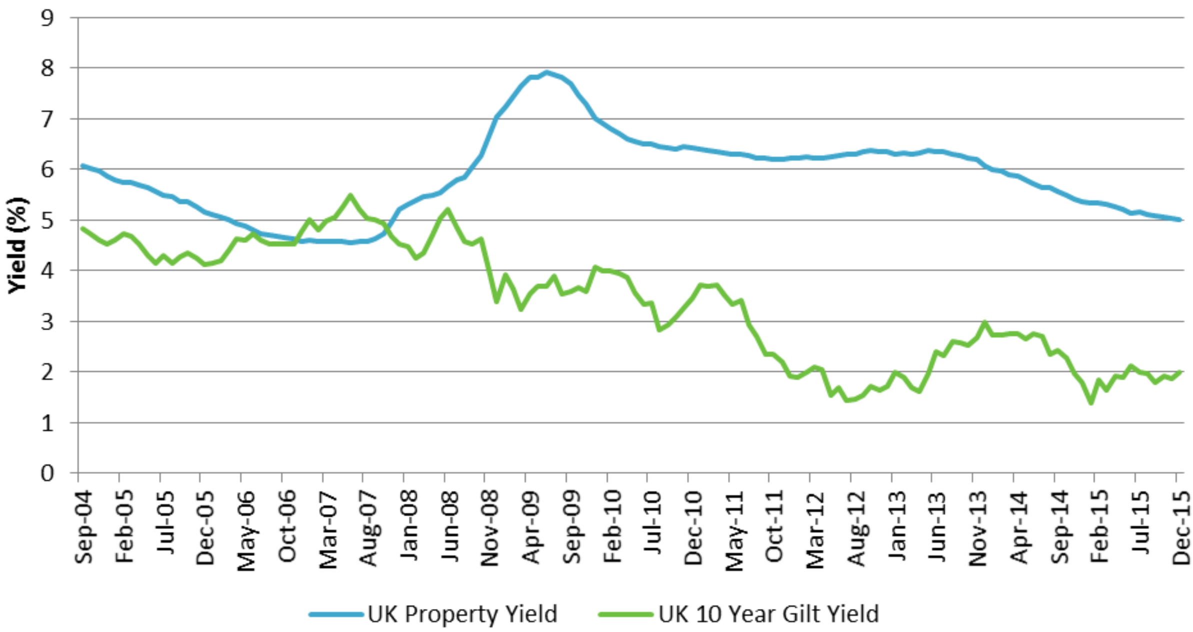
Over the fourth quarter of 2015, Sterling weakened against the Dollar and Euro and was broadly flat versus the Yen. Since quarter end it has weakened significantly against the Dollar, Euro and Yen.

Chart 6: Sterling performance to 13 January 2016 (%)



UK Property





- UK property delivered a return of 3.1% over the quarter. Over the last 12 months the overall property return was 13.8%.
- Over the 3 months to end December 2015, returns were strong across all sectors (retail +2.3%, office +3.6% and Industrial +3.8%). Over the twelve month period, Office (+18.2%) and Industrial (+17.3%) outperformed Retail (+8.9%). However, all sectors returns remain particularly strong.
- Capital values continue to push ahead month by month at a healthy pace – income yields are as low as they have been since the end of 2007 although the yield difference between property and gilts remains extended.

Prepared by:-

Matt Woodman, Senior Investment Consultant

David Millar, Senior Investment Analyst

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.