Independent Adviser's Public Report for Nottinghamshire Pension Fund Committee

William Bourne **12th March 2020**

Market commentary

1. Six weeks ago I commented that the background was quite equity-friendly, with BREXIT and trade uncertainty reduced, and generally supportive policy from both governments and central banks. Despite major long-term imbalances which must one day be addressed, I expected bond and equity markets to carry on their gentle upward path until some catalyst upsets it.

2. At a high level little has changed, though perhaps trade tensions have eased. While there are plenty of threats to markets, investors have taken the view that central banks and government are reacting to the risks around today by printing more money and easing fiscal policy. It is noteworthy that the US equity market has made new highs and coronavirus has had only a limited impact, even on the Chinese and Hong Kong stock-markets.

3. Perhaps bond markets, like last summer, are showing more signs of stress. Yields have continued to fall and, for example, the UK 10 year gilt yield at 0.5% in early February was close to its lowest level last year. In the US, the yield curve has inverted (ie. you get paid more for holding money for three months than for 10 years) which is a traditional signal of trouble ahead.

4. Growth in the world in 2019 has been, as I have previously commented, very low by historic standards. The US grew by 2.1% but European growth has in aggregate been close to 1%. BREXIT uncertainty has clearly been a contributor both in the UK and Europe, but I believe the underlying causes have more to do with demographics and lack of wealth creation.

5. Forecasters remain downbeat about economic growth (and by implication corporate earnings) because of trade worries, coronavirus and the consequences of BREXIT. While it is not my central forecast the risk remains that low growth and low inflation leads the West into Japan style deflation. Central banks seem to be aware of this risk, as their policy needle is clearly at the loose end of the dial. I expect governments to react similarly and use fiscal policy to try and avoid the risk of deflation taking hold, so am more positive about the economic outlook than some.

6. The appointment of Rishi Sunak as Chancellor and the approval of HS2 are signals of a likely significant increase in U.K. Government spending. The Bank of England has been notably less supportive than other central banks over the past 12 months, which may be a case of keeping their powder dry in case of trouble while post-BREXIT negotiations with the European Union take place. Not much will change in the transition period lasting until 31 December 2020, but there are likely to be significant bumps in the road as we approach that date. But the combination of greater spending and potentially looser monetary policy means the U.K. economy may provide a significant positive surprise.

7. In investment one learns to expect the unexpected. While I did suggest in January that any slowdown might come out of China, I had no inkling that the coronavirus was about to be unleashed on the world. The virus may, or may not, prove to be more devastating than previous flu-like epidemics but the way that 'authority' has responded undoubtedly has the potential to be damaging to both the Chinese and the global economy. With parts of China in lockdown and travel to some regions of the world severely curtailed, there will inevitably be a negative impact on global growth.

8. This will come from three discrete sources. First is the impact on globalised industries such as autos. If Chinese factories are not manufacturing parts, there will be shortages, much as after the Japanese tsunami in 2011, which will affect global production. Secondly, Chinese GDP forecasts are already down to 2%, the lowest since the Global Financial Crisis, because of the slow-down in activity. Thirdly, Chinese consumers are major customers for a range of global industries such as travel, tourism and luxury goods. Companies in these sectors will inevitably be affected.

9. For investors the question has been whether lower earnings from lower economic growth is reason enough to move out of equities. So far they have chosen not to, largely because other asset classes look unattractive compared to the dividend stream which equities offer. They also assume that central banks would react to trouble by being even more supportive. They are effectively once again calling the bluff of the central banks – as has happened for much of the past 20 years.

10. Looking forward, the default case for markets globally is a continuation of the current trends over the next year or two. As explained above, I expect economic growth to surpass expectations, especially in the U.K., but that may not necessarily be reflected in stockmarket performance.

11. There is always the possibility that political events knock the market off its course:
    - Unrest in China if the economic slowdown turns into recession.
    - Uncertainty in the US over the 2020 election.
    - Tensions over the Middle East and oil.

RECOMMENDATION/S

That members consider whether there are any actions they require in relation to the issues contained within the report.