Non-Executive Report of the: **Pensions Committee** 24 July 2018	
Report of: Zena Cooke, Corporate Director, Resources	**Classification:** Unrestricted
Market and Economic Outlook by the Independent Adviser	

Originating Officer(s)	Bola Tobun, Investment & Treasury Manager
Wards affected	All wards

Summary

This report presents the views of the Independent Adviser in respect of the performance of the markets and the Pension Fund investment managers for the fourth quarter of 2017/18.

The Independent Adviser will be present at the meeting to present his views and take questions from Members.

Recommendations:

Members are recommended to note the contents of this report

1. REASONS FOR THE DECISIONS

1.1. The report presents the Pensions Committee with the views of the Fund Independent Adviser on markets and the performance of the Fund pension fund managers and the overall performance of the Tower Hamlets Pension Fund.

2. ALTERNATIVE OPTIONS

2.1. The Pension Fund Regulations require that the Council establishes arrangements for monitoring the investments of the Pension Fund and to engage the use of an expert in gaining required knowledge and advice. There is little alternative but to note the views of the Independent Adviser of the Fund to the Pension Committee on a regular basis,

3. MARKETS AND ECONOMICS UPDATE (Quarter to 30 June 2018) FROM THE INDEPENDENT ADVISER TO THE FUND – Colin Robertson

Market performance

3.1 Financial markets regained their composure in the 3 months to 30 June 2018. In local currency terms, developed equity markets largely recovered their first quarter falls and the volatility of day to day price movements subsided. While the issues behind the earlier falls, notably the US / China trade war, have certainly not gone away, the situation is at present perceived by investors as likely to be manageable and the technical distortions within equity markets have been corrected for the time being.

3.2 However, emerging markets experienced a torrid quarter with the Chinese equity market meeting the definition of a bear market by falling 20 % from its recent peak as concerns over a slowing Chinese economy and what this might mean for the country's debt increased. Elsewhere, rising US interest rates and a stronger US dollar placed pressure on intrinsically weak countries such as Argentina.

3.3 Bond markets have gyrated, tending to react to the developments affecting equity markets but in the opposite direction (bond prices falling as equity prices rose). The more sustained trends have been for US Treasury yields to rise (prices fall), German yields to fall and UK gilt yields to be fairly stable.

Economics and markets

3.4 The backdrop for equity markets has been favourable. Economic growth has continued at a moderate level, be it some slowing has been evident in Continental Europe and growth in Japan has been rather precarious. Inflation has shown signs of converging to the commonly held target of 2% for the major economies. With wage inflation subdued, this has led to strong corporate earnings growth in the US of over 20%, admittedly boosted by corporate tax cuts, but double digit earnings per share growth for 2018 is also forecast in the UK and Europe.

3.5 As the major equity markets are at broadly the same levels as they started the year, this robust earnings growth has led to equity market valuations becoming cheaper. Nevertheless, valuations remain demanding from an historical perspective. In particular, the valuations of the so called FANGS – the very largest US technology/growth companies which include Amazon and Netflix – are very high, raising fears of investor overenthusiasm within this part of the US stock market.

3.6 Meanwhile the risks are accumulating and becoming more severe. The Trump inspired trade wars have the potential to truly disrupt the world economy as global supply chains break down. Trump's trade policy makes no economic sense as increased US fiscal spending will need to be financed by foreigners, which for all practical purposes means running a larger trade deficit. Geopolitically, the situation with North Korea is far from resolved while the US approach to Iran is fraught with danger. In Europe, Brexit is liable to be disruptive for the Eurozone as well as for the UK and the new populist Italian government will provide challenges for the rest of the Eurozone.

3.7 A major threat to financial markets lies in the reversal of central bank policies of low or negative interest rates and "quantitative easing" which have driven markets up. This unwinding is now well under way in the US but only at a tentative stage in Europe and is yet to begin in Japan. Unwinding is necessary because otherwise there will be no scope for monetary policy to boost growth in the next economic downturn and inflation might well rise to unacceptable levels over time. However if the unwinding is implemented clumsily or prematurely, then both equity and bond markets will suffer.

Asset allocation

3.8 The basic problems for asset allocation are that very few asset classes appear attractively valued, there is no shortage of potential triggers to cause markets to fall and some of the relatively more attractively valued asset classes could be expected to be most sensitive in the short term to a general fall in markets. Moreover, in the same way as the injection of liquidity by central banks lifted virtually all asset classes, the withdrawal of liquidity, if badly handled, is likely to leave few places to hide. In these circumstances, it makes sense to diversify away from investments highly dependent on market levels into those more reliant on investment manager skill and to take out a measure of protection through derivative markets where this can be achieved on attractive terms.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

4.1. The costs of having an independent adviser are estimated to be in the region of £20k - £35k per annum and will be met from the pension fund. The work carried out by the independent advisors informs the content of this report. There are no other direct financial implications arising from this report.

4.2. The governance role of the Pensions Committee requires that they ensure that they take proper advice at reasonable intervals about its investments and must consider such advice when taking any steps in relation to its investments.

4.3. Understanding and being aware of the financial markets and its economics dynamics will assist the Committee in considering the longer term financial

impact of its strategy for the Pension Fund and the investment decisions it makes as a consequence.

5. LEGAL COMMENTS

5.1. In accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Council must take proper advice about its investments and must consider such advice when taking any steps in relation to its investments. Where the Council appoints an investment manager, it must keep the manager's performance under review. At least once every three months the Council must review the investments that the manager has made and, periodically, the Council must consider whether or not to retain that manager. One of the functions of the Pensions Committee is to meet the Council's duties in respect of investment matters. It is appropriate, having regard to these matters, for the Committee to receive information about the performance of the markets and the performance of appointed investment managers. The Committee's consideration of the information in the report contributes towards the achievement of the Council's statutory duties.

5.2 When reviewing the Pension Fund Investment Performance, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector duty). The Committee may take the view that good, sound investment of the Pension Fund monies will support compliance with the Council's statutory duties in respect of proper management of the Pension Fund.

6. ONE TOWER HAMLETS CONSIDERATIONS

6.1. The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.

6.2. A viable pension scheme also represents an asset for the recruitment and retention of staff to deliver services to the residents.

7. BEST VALUE (BV) IMPLICATIONS

7.1. This report helps in addressing value for money through benchmarking the Council's performance against the WM Local Authority Universe of Funds.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

8.1. There is no Sustainable Action for A Greener Environment implication arising from this report.

9. RISK MANAGEMENT IMPLICATIONS

9.1. Any form of investment inevitably involves a degree of risk.

9.2. To minimise risk the Council attempts to achieve a diversification portfolio. Diversification relates to asset classes and management styles.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

10.1. There are no crime and disorder reduction implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report

- [None]

Appendices

- [None]

Local Government Act, 1972 Section 100D (As amended)
List of "Background Papers" used in the preparation of this report

- [None]

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