REPORT PREPARED FOR

Worcestershire County Council Pension Fund

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Independent Investment Adviser's report

Global overview

There were two main themes playing on investors' minds during the "holiday" quarter; the continuing cogitations on the implications of "Brexit", and the deepening farce of "The US Presidential Election Show". We now know the outcome of the latter, more of which below. On Brexit, it seemed to take a spat between Unilever and Tesco about the increase in the price of Marmite to wake people up to the reality of the implications in the sharp decrease in the value of Sterling versus the US$, and also the Euro.

On Tuesday 8 November I spotted this headline about the US election, "Today America chooses between two candidates who are simply unfit for office". I am writing this with a large bit of the morning after the night before feeling, now the choice has been made. For better or for worse, we will all have to learn to live with the fact that Donald Trump will be the next President of the United States of America. It is to be hoped that now the election is over the bluster and rhetoric that has formed so much of the campaign will now die away, and instead the focus will now be on what Mr Trump will do in reality, particularly as he ostensibly has the support of Congress. That support may well be qualified, and may provide some break on some of his more extreme proposals. At this stage it is difficult to predict the eventual impact on the economy in the medium to long term, but at least for the time being economic data in the US is encouraging.

In the UK, it's all about "Brexit". From an economic viewpoint, so far so good, in the short term. There are the emerging ramifications of the fall in the value of sterling, including higher inflation, but ultimately this may well do more good than harm. The Prime Minister has taken the stance that from a negotiating point of view, the exit has to be clear cut, otherwise her Government's bargaining power would be compromised. There are others who seek a softer stance.

With regards to Europe, I am drawn to the comments that Martin Gilbert, CEO of Aberdeen Asset Management, made following the US election. "Trump's victory is another example of a vote against the status quo. As with the UK referendum, many people voted against the establishment as they believed they have been ignored for many years and the recent low growth, non-inclusive growth environment has only accentuated this feeling. In the upcoming elections and referendums taking place across Europe we are likely to witness further votes against the establishment. So political risk will remain a firm part of the investment landscape for the foreseeable future." In the near term there is the Italian referendum on constitutional reforms to consider, the outcome of which can hardly be deemed to be certain. Who would now bet against the prospect of Marine Le Pen being elected in the French General Election next year?

I am glad to be a bit more positive about the Japanese economy this time, having begun to wonder what it would take to see an improvement. This improvement in data helped cyclical sectors to significantly outperform. There remain issues with weak domestic consumption, and the consequences of the eventual unwinding of monetary easing.

Emerging Markets as a group enjoyed another good quarter, with less emphasis on commodity pricing issues. China was the stand out performer, with heavy stimulus to the property sector. The snag is that this has added yet more debt to the outstanding balance, so the boost to confidence may yet turn out to be short lived. Brazil continued to benefit from improved political stability, maybe also the relief element that the Olympic Games passed off well helped sentiment. Turkey had a bit of a local issue, namely a failed coup. The potential cloud on the horizon is President elect Trump, with his declared trade policy having a detrimental impact on emerging markets.

Worcestershire County Council Pension Fund — Quarter to end September 2016

Summary and Market Background

The value of the Fund in the quarter rose to £2.237bn, an increase of £171m compared to the end June value of £2.066bn. The Fund produced a return of 8.3% over the quarter, which gave an outperformance against the benchmark of 0.8%. Over a 12 month period the Fund recorded a positive relative return against the benchmark of 1.4% (24.9% v. 23.5%).

The third quarter 2016 was an excellent period for the Fund's active managers. The three active equity mandates all outperformed their benchmarks in Q3, with JP Morgan (Emerging Markets) leading the field at 2.6%, followed by Schroders (Emerging Markets) at 1.5% and Nomura (Pacific) by 1.4%. JP Morgan (Bonds) also outperformed, by 0.4%.
The alternative passive strategies have continued to produce a return ahead of their respective benchmarks (0.2% in aggregate), and ahead of the traditional passive index benchmark.

Rather to my surprise world markets enjoyed another good quarter, certainly on a sterling adjusted basis. The MSCI World Index showed a rise of 8.5%. The grouping of Asian developed and all emerging markets fared best, with a rise in the MSCI Asia Pacific ex Japan of 13%, closely followed by Emerging Markets at 12.3%. Japan was up 11.9%. Emerging Markets are up 32% for the year to date at 30 September. Europe rose 9.2%, the UK FTSE All-Share rose 7.8% and if there was a laggard, it was the US at "only" 7.1%.

Bond markets, both Government and Corporate, also saw strong performance in total returns. With concerns about higher inflation, not surprisingly UK index linked fared best (11.0%), but we also saw a strong performance from corporate bonds, particularly US corporate high yield, up 8.6%. Again some of the sterling adjusted returns for 2016 to the end of September are quite extraordinary, some indices being up over 30%, with the Barclays Global Aggregate Bond index up 20%.