MERCER

CLWYD PENSION FUND
ECONOMIC AND MARKET UPDATE
PERIOD ENDING 30 SEPTEMBER 2019

MARSH & McLENNAN COMPANIES

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1 MARKET BACKGROUND
PERIOD ENDING 30 SEPTEMBER 2019

MARKET STATISTICS

Market Returns Growth Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	1.3	2.7	6.8
Overseas Developed	3.9	8.2	12.8
North America	4.9	10.4	15.1
Europe (ex UK)	1.6	6.3	10.0
Japan	6.6	0.3	8.4
Asia Pacific (ex Japan)	-1.6	3.7	8.1
Emerging Markets	-0.5	7.1	8.4
Frontier Markets	-7.0	0.2	3.2
Property	0.6	2.9	7.7
Hedge Funds[3]	0.3	2.1	3.8
Commodities[2]	-4.7	-18.5	-0.3
High Yield[2]	0.9	5.4	4.6
Emerging Market Debt	2.5	16.5	4.9
Senior Secured Loans[2]	0.9	1.4	2.7
Cash	0.2	0.7	0.5

Market Returns Bond Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Gilts (>15 yrs)	11.0	23.0	5.3
Index-Linked Gilts (>5 yrs)	8.7	20.3	5.3
Corporate Bonds (>15 yrs AA)	8.5	21.0	5.2
Non-Gilts (>15 yrs)	7.8	19.3	4.8

Exchange Rates: Change in Sterling	3 Mths %	1 Year %	3 Years % p.a.
Against US Dollar	-3.17	-5.50	-1.74
Against Euro	1.14	0.68	-0.74
Against Yen	-2.87	-10.09	0.41

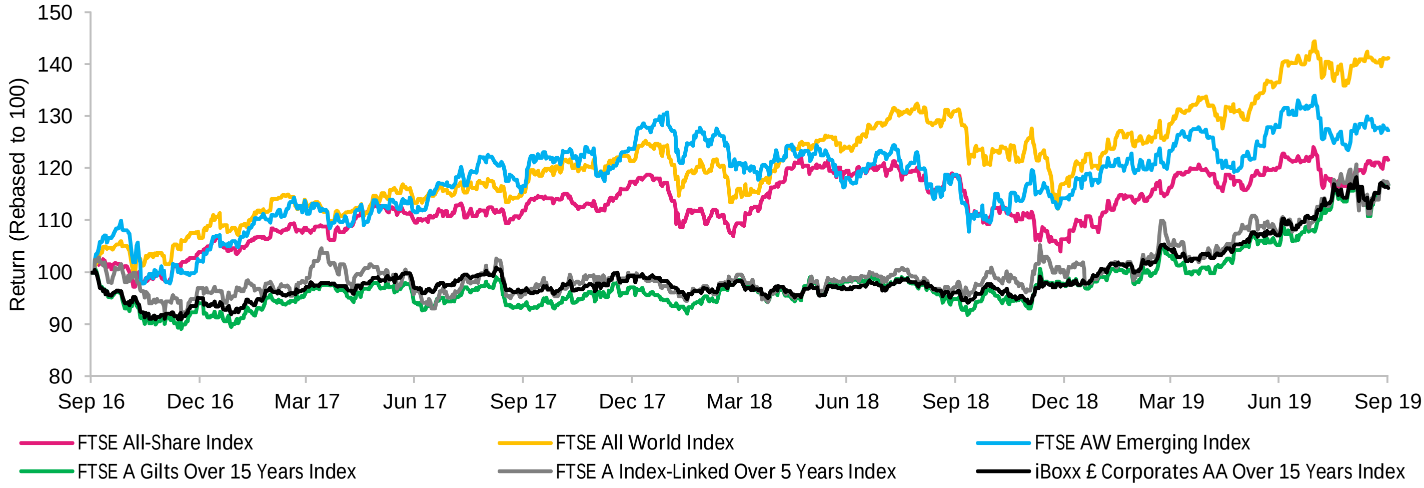
Inflation Indices	3 Mths %	1 Year %	3 Years % p.a.
Price Inflation – RPI	0.5	2.4	3.2
Price Inflation – CPI	0.5	1.7	2.4
Earnings Inflation[1]	0.9	3.4	3.1

Yields	% p.a.
UK Equities	4.21
UK Gilts (>15 yrs)	0.91
Real Yield (>5 yrs ILG)	-2.20
Corporate Bonds (>15 yrs AA)	1.81
Non-Gilts (>15 yrs)	2.33

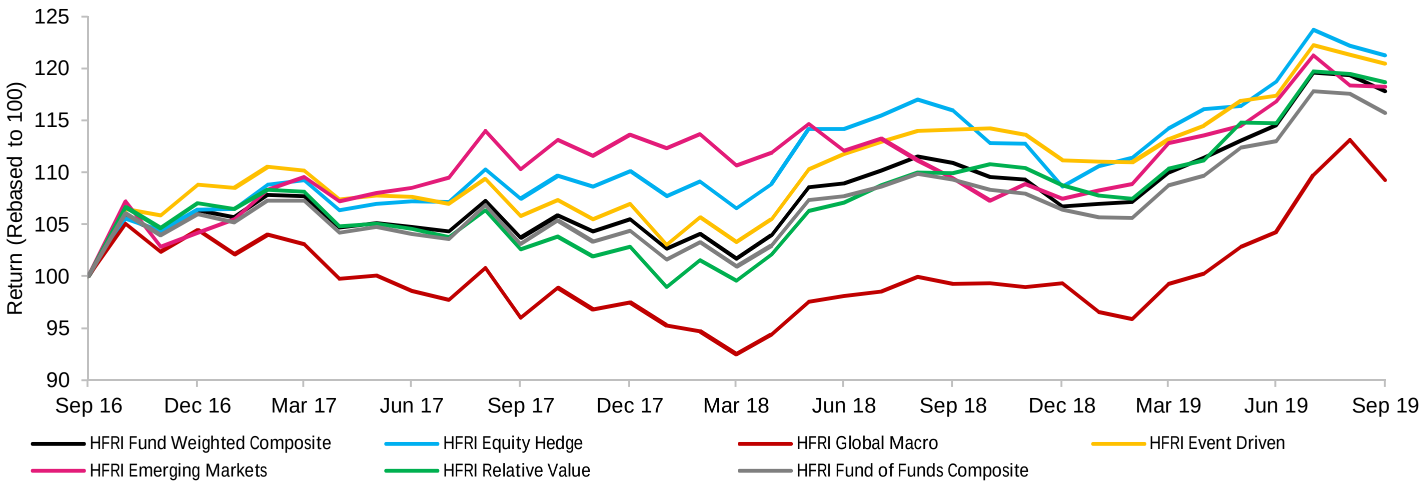
Absolute Change in Yields	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	0.08	0.41	0.75
UK Gilts (>15 yrs)	-0.49	-0.95	-0.51
Real Yield (>5 yrs ILG)	-0.31	-0.71	-0.42
Corporate Bonds (>15 yrs AA)	-0.44	-1.00	-0.42
Non-Gilts (>15 yrs)	-0.45	-0.94	-0.27

Source: Refinitiv.
Notes: [1] Subject to 1 month lag. [2] GBP Hedged. [3] Local Currency.

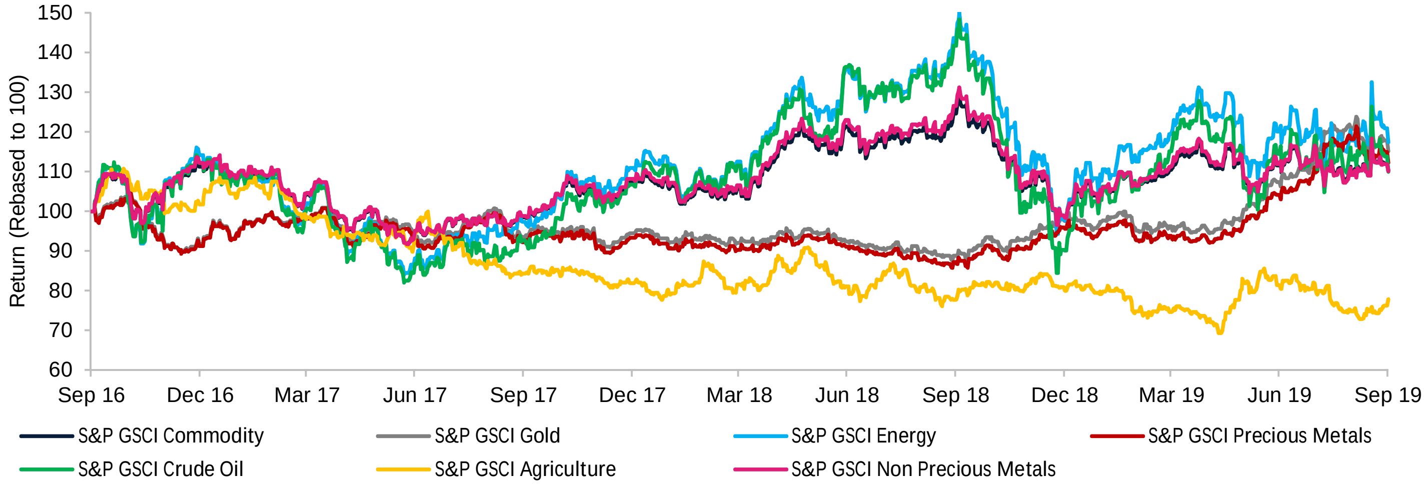
Market performance – 3 years to 30 September 2019



Hedge Funds: Sub-strategies performance – 3 years to 30 September 2019

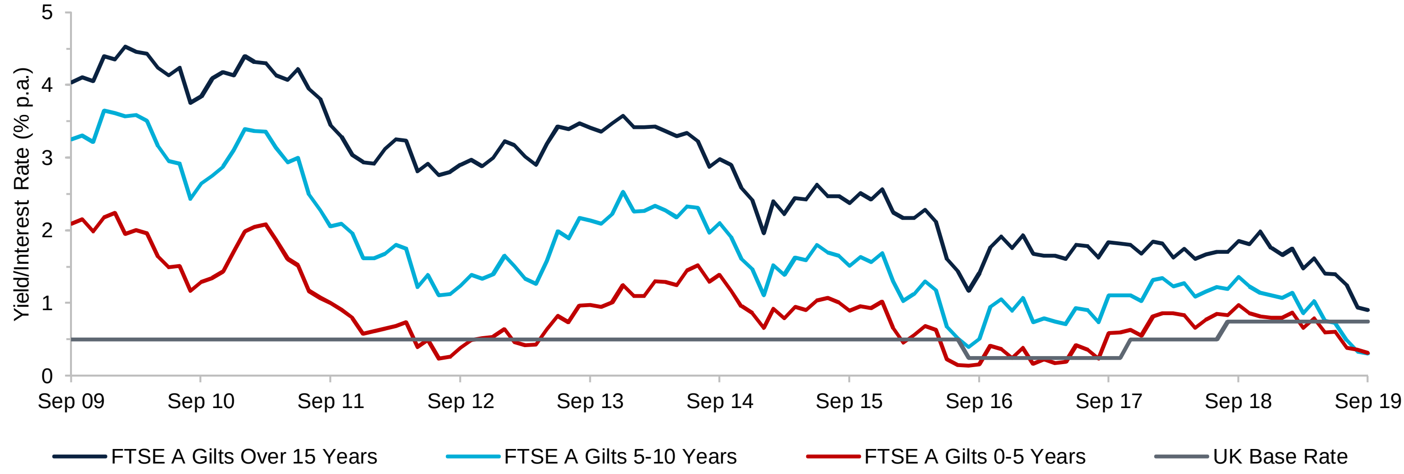


Commodities: Sector performance – 3 years to 30 September 2019

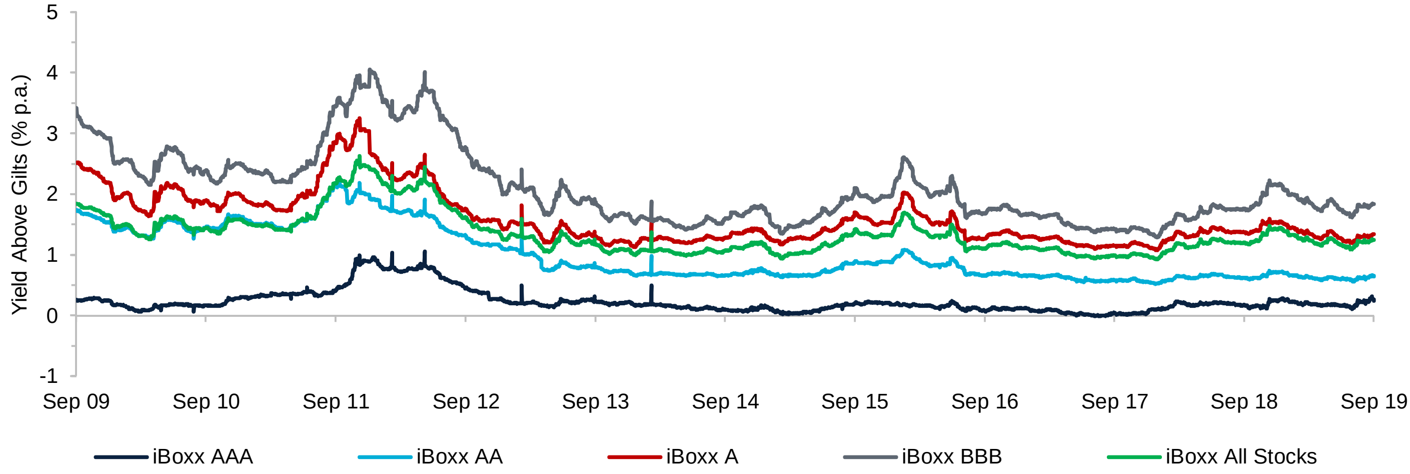


Source: Refinitiv

UK government bond yields – 10 years to 30 September 2019



Corporate bond spreads above government bonds – 10 years to 30 September 2019



Source: Refinitiv

2 ECONOMIC STATISTICS

Economic Statistics as at:	30 September 2019			30 June 2019			30 September 2018		
30 September 2019	**UK**	**Euro[1]**	**US**	**UK**	**Euro[1]**	**US**	**UK**	**Euro[1]**	**US**
Annual Real GDP Growth[2]	1.3%	2.8%	2.3%	2.1%	2.9%	2.7%	1.3%	3.4%	3.2%
Annual Inflation Rate[3]	1.7%	0.8%	1.7%	2.0%	1.3%	1.6%	2.4%	2.1%	2.3%
Unemployment Rate[4]	3.9%	7.5%	3.6%	3.8%	7.6%	3.6%	4.0%	8.0%	3.8%
Manufacturing PMI[5]	48.3	45.7	51.1	48.0	47.6	50.6	53.7	53.2	55.6

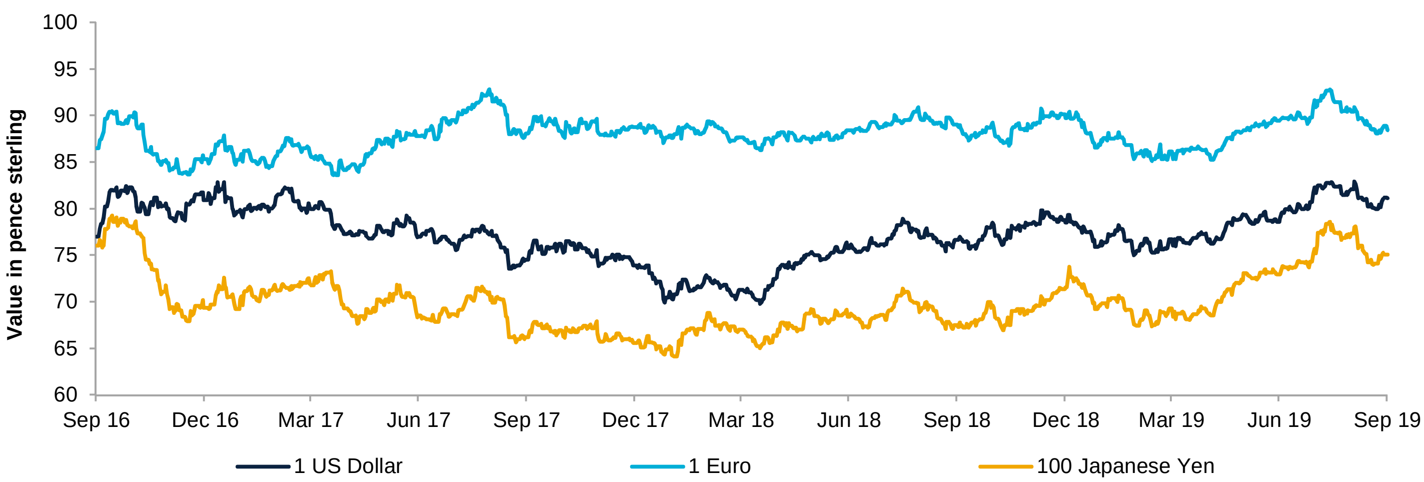
Change over periods ending:	3 months			12 months		
30 September 2019	**UK**	**Euro[1]**	**US**	**UK**	**Euro[1]**	**US**
Annual Real GDP Growth[2]	-0.8%	-0.1%	-0.4%	0.0%	-0.6%	-0.9%
Annual Inflation Rate[3]	-0.3%	-0.5%	0.1%	-0.7%	-1.3%	-0.6%
Unemployment Rate[4]	0.1%	-0.1%	0.0%	-0.1%	-0.5%	-0.2%
Manufacturing PMI[5]	0.3	-1.9	0.5	-5.4	-7.5	-4.5

Notes: 1.Euro Area 19 Countries. 2. GDP is lagged by 3 months. 3. CPI inflation measure. 4. UK unemployment is lagged by 1 month. 5. Headline Purchasing Managers Index.

EXCHANGE RATES

Economic Statistics as at:	Value in Sterling (Pence)			Change in Sterling	
30 September 2019	**30 Sep 19**	**30 Jun 19**	**30 Sep 18**	**3 months**	**12 months**
1 US Dollar is worth	81.15	78.57	76.68	-3.2%	-5.5%
1 Euro is worth	88.47	89.48	89.07	1.1%	0.7%
100 Japanese Yen is worth	75.09	72.93	67.51	-2.9%	-10.1%

Exchange rate movements – 3 years to 30 September 2019



Source: Refinitiv, Markit, Institute for Supply Management, Eurostat, US Department of Labor and US Bureau of Economic Analysis.

3 MARKET COMMENTARY

INTRODUCTION

Equity markets were more sanguine during the third quarter, following a strong upward trend in the first half of 2019. The notable exceptions over the quarter have been the equity markets of the US and Japan.

Trade tensions remain high with the US and China still in dispute and introducing further tariffs. A resolution to settle the one-and-a-half year spat between both countries has become less likely, with news flow from China becoming more influential in equity market reactions, while the prospect of a sudden rupture between the UK and EU and the trade disruption this would cause is becoming an increasingly likely scenario.

Recent economic data around the world has been mixed. Whilst the US economy appears to be supported by consumer spending, the manufacturing and business investment data is weaker. Outside the US, a deceleration is more apparent with China slowing and European GDP contracting in the second quarter, particularly in Germany and Italy.

The US Federal Reserve's Open Market Committee (FOMC) cut its interest rates twice over the quarter. The first rate cut in July put the benchmark rate in the target range of 2.0% to 2.25%. The second rate cut in September moved the target range to 1.75% to 2.0%. Since the end of the quarter, the FOMC has cut rates for the third time putting the benchmark rate in the target range of 1.5% to 1.75%. The reductions in rates are an attempt by the FOMC to prevent economic expansion from slowing down amid the global slowdown. The European Central Bank (ECB) also cut its key deposit rate to a new record low of minus 0.5%, and announced the resumption of its quantitative easing programme, with the purchase of assets worth €20bn a month for an indefinite period starting in November.

UNITED KINGDOM

- UK equity markets have been increasingly volatile over the quarter as the new Prime Minister, Boris Johnson, engaged with the opposition in Parliament and the European Union.
- Markets became increasingly unsettled as the 31 October deadline for leaving the EU approached. This uncertainty has also fed through into the behaviour of Sterling, the value of which has swung on Brexit news flow.
- The uncertainty has also shown itself in the low levels of confidence demonstrated by forward looking industry data. There is however an expectation that the budget due later this year will contain a number of stimulus packages, some of which have been announced already, that could help a stuttering UK economy.

NORTH AMERICA

- The US market appears to be well supported by the consumer at present and the looser monetary policy from the US Federal Reserve; however, there are signs of the economy softening in other sectors with weaker earnings forecasts. This softening is of particular interest as the 2020 election year approaches.
- The ongoing trade tensions between the US and China are proving to be a drag on the economy and the current impeachment attempts on the President are not helpful to investment markets.

EUROPE (EX UK)

- The risk of recession in Germany and Italy is now very high indeed even with the additional support of another bout of ECB Quantitative Easing.
- European equity market growth has been good year to date; however, the third quarter saw a flattening of the market over company performance concerns.
- The appointment of Christine Lagarde as the head of the ECB, replacing Mario Draghi, is seen as a positive move and a continuation of the policies that the ECB took in the wake of the financial crisis.

JAPAN

- The strong recovery from the lows of 2018 continued apace with Japan being the standout market over the third quarter. Japan is seen and considered to offer a relative safe haven during this phase of the market, particularly when considered alongside the Yen.
- An agreed, but as yet signed-off trade agreement between the US and Japan, as well as constructive trade negotiations with the EU has been seen as a positive impetus for the Japanese economy.
- The recent change of Emperor in Japan, the first abdication since 1817, will see the Enthronement Ceremony likely taking place in the final quarter of 2019. This event is seen largely as a change of era in Japan and a sense of optimism surrounds the country.

ASIA PACIFIC (EX JAPAN) / EMERGING MARKETS

- The ongoing trade negotiations between China and the US are not providing markets with the clear direction they would like, however, with adversity comes opportunity as other countries are starting to consider how they can benefit from the lack of progress, particularly where they are not caught or indirectly adversely affected by China/US tariffs.
- It is also notable that slowing global growth is starting to impact equity markets in the region which, combined with heighted social unrest, specifically in Hong Kong, is creating a drag on the region's equity markets.
- The third quarter saw emerging market equities take a step backwards, delivering a slight negative performance over the quarter – this is as a result of the strengthening US Dollar starting to raise concerns again in tandem with slowing global growth on the back of rising trade tensions.

FIXED INCOME

- The recent cutting of interest rates globally has contributed to a slightly more attractive market in debt, although this is tempered to a degree by liquidity concerns.
- That said there remains a strong demand for safe haven assets, even in a low and falling yield environment.
- Brexit uncertainty still persists and gilt yields could push lower through this prolonged period of uncertainty and offer protection in what is proving a difficult period for the UK.

ALTERNATIVES

- Hedge Funds had a positive third quarter, as all strategies posted gains in Sterling terms. Overall, Hedge Funds returned 2.9% in Sterling terms and -0.4% in US dollar terms. Global Macro strategies were the best performing strategies, returning 4.8% (Sterling) and 1.5% (US dollar). Emerging Market strategies were once again the worst performing strategies over the quarter, returning 1.3% (Sterling) and -2.0% (US dollar).
- Commodities had a negative quarter, returning -1.0% in Sterling terms (-4.2% in US dollar terms). Precious Metals and Gold were the best performing commodities returning 7.8% and 7.2%, respectively in Sterling terms (3.8% and 4.4% in US dollar terms). Agriculture was the worst sector, returning -4.3% (Sterling) and -7.3% (US dollar). Crude Oil, Non-Precious Metals and Energy declined in both Sterling and US dollar terms.
- Property returns were unchanged from the previous quarter, returning 0.6% over the period as Brexit uncertainty and a slowdown in economic activity continue to impact the sector. Within the retail sector, several retailers have announced store closures and are increasingly requesting for large cuts in rent. Within industrials, rental growth has eased, reflecting weaker demand from manufacturers.

OUTLOOK

There is an increasing risk of a global recession as trade tensions depress global manufacturing, along with uninspiring earnings growth, diminishing business confidence and a break in capital expenditures. Although markets are cautious for now, a combination of central bank easing, a trade-war resolution and China stimulus could brighten the outlook.

Since end of the quarter, Brexit has been delayed until 31 January 2020, with a UK general election to go ahead on 12 December 2019. Boris Johnson will look to increase the Conservative majority to get his deal with the EU through, where as the opposition parties will look to offer either a second referendum or revoke Article 50 altogether.

4 MARKET STATISTICS INDICES USED

Asset	Index
Growth Assets	
UK	FTSE All-Share Index
Overseas Developed	FTSE World (ex UK) Index
North America	FTSE North America Index
Europe (ex UK)	FTSE World Developed Europe (ex UK) Index
Japan	FTSE Japan Index
Asia Pacific (ex Japan)	FTSE AW Developed Asia Pacific (ex Japan) Index
Emerging Markets	FTSE All Emerging Index
Frontier Markets	FTSE Frontier 50 Index
Property	IPD UK Monthly Property Index
Hedge Funds	Credit Suisse Hedge Fund Index (Local Currency)
Commodities	S&P GSCI TR Index (GBP Hedged)
High Yield	ICE BoAML Global High Yield Index (GBP Hedged)
Emerging Markets Debt	JPM GBI-EM Global Diversified Composite Index
Senior Secured Loans	S&P Leveraged Loan Index (GBP Hedged)
Cash	UK SONIA Index
Bond Assets	
UK Gilts (>15 yrs)	FTSE A Gilts Over 15 Years Index
Index-Linked Gilts (>5 yrs)	FTSE A Index-Linked Over 5 Years Index
Corporate Bonds (>15 yrs AA)	iBoxx £ Corporate Over 15 Years AA Index
Non-Gilts (>15 yrs)	iBoxx £ Non-Gilts Over 15 Years Index
Yields	
UK Equities	FTSE All-Share Index (Dividend Yield)
UK Gilts (>15 yrs)	FTSE A Gilts Over 15 Years Index (Gross Redemption Yield)
Real Yield (>5 yrs ILG)	FTSE A Index-Linked Over 5 Year Index 5% Inflation (Gross Redemption Yield)
Corporate Bonds (>15 yrs AA)	iBoxx £ Corporate Over 15 Years AA Index (Gross Redemption Yield)
Non-Gilts (>15 yrs)	iBoxx £ Non-Gilts Over 15 Years Index (Gross Redemption Yield)
Inflation	
Price Inflation – RPI	UK Retail Price Index (All Items NADJ)
Price Inflation – CPI	UK Consumer Price Index (All Items NADJ)
Earnings Inflation	UK Average Weekly Earnings Index (Whole Economy excluding Bonuses NADJ)
Exchange Rates	
USD / EUR / JPY vs GBP	WM/Reuters 4:00 pm Closing Spot Rates

Note: All indices above are denominated in Sterling unless stated otherwise.

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