CLWYD PENSION FUND

ECONOMIC AND MARKET UPDATE
PERIOD ENDING 30 JUNE 2016

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1 MARKET BACKGROUND
PERIOD ENDING 30 JUNE 2016

MARKET STATISTICS

Market Returns Growth Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	4.7	2.2	5.9
Global Developed Equities	8.8	15.1	12.2
USA	10.3	21.4	16.2
Europe	4.4	6.3	7.3
Japan	8.8	7.8	8.0
Asia Pacific (ex Japan)	8.5	6.8	6.6
Emerging Markets	8.4	3.9	3.0
Frontier Markets	8.2	3.9	5.8
Property	1.3	9.2	14.2
Hedge Funds	9.7	15.0	7.4
Commodities	21.1	-13.0	-16.4
High Yield	12.3	20.2	8.2
Emerging Market Debt	5.0	9.8	7.2
Senior Secured Loans	-0.6	2.6	4.6
Cash	0.1	0.5	0.5

Market Returns Bond Assets	3 Mths %	1 Year %	3 Years % p.a.
UK Gilts (>15 yrs)	11.8	24.1	15.0
Index-Linked Gilts (>5 yrs)	11.1	17.0	12.2
Corporate Bonds (>15 yrs AA)	9.8	17.6	12.2
Non-Gilts (>15 yrs)	8.3	15.4	11.2

Exchange Rates: Change in Sterling	3 Mths %	1 Year %	3 Years % p.a.
Against US Dollar	-7.0	-15.0	-4.1
Against Euro	-4.6	-14.8	1.0
Against Yen	-15.1	-28.7	-3.1

Inflation Indices	3 Mths %	1 Year %	3 Years % p.a.
Price Inflation – RPI	0.8	1.6	1.8
Price Inflation – CPI	0.5	0.5	0.8
Earnings Inflation*	0.9	2.0	1.8

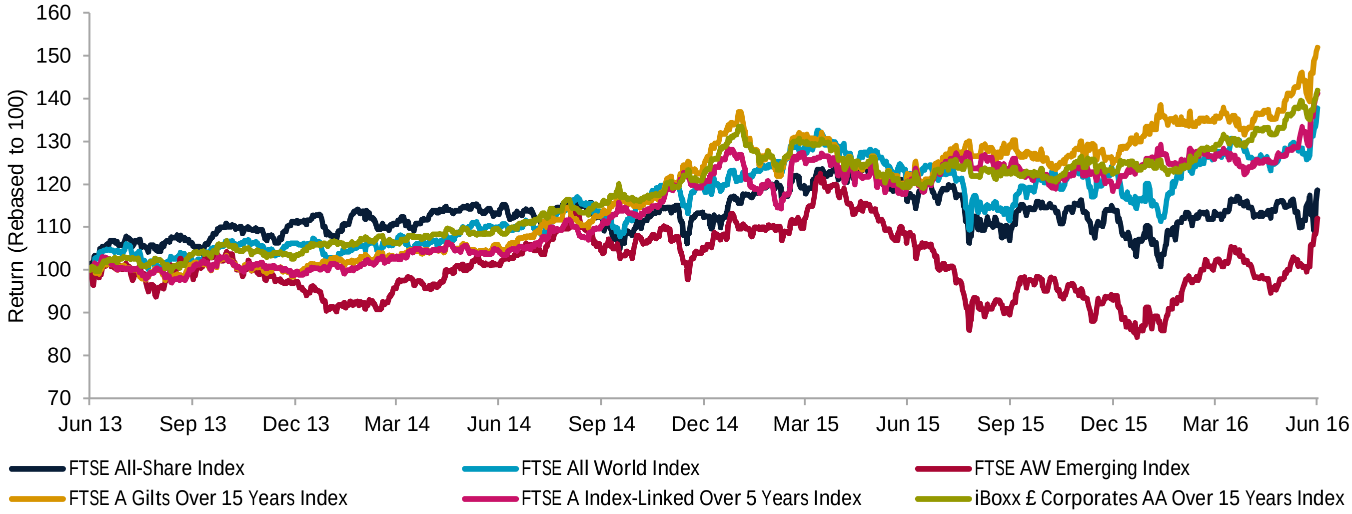
Yields as at 30 June 2016	% p.a.
UK Equities	3.66
UK Gilts (>15 yrs)	1.61
Real Yield (>5 yrs ILG)	-1.39
Corporate Bonds (>15 yrs AA)	2.75
Non-Gilts (>15 yrs)	3.19

Absolute Change in Yields	3 Mths %	1 Year %	3 Years % p.a.
UK Equities	-0.11	0.20	0.13
UK Gilts (>15 yrs)	-0.56	-1.02	-1.82
Real Yield (>5 yrs ILG)	-0.41	-0.63	-1.36
Corporate Bonds (>15 yrs AA)	-0.60	-0.93	-1.77
Non-Gilts (>15 yrs)	-0.52	-0.78	-1.49

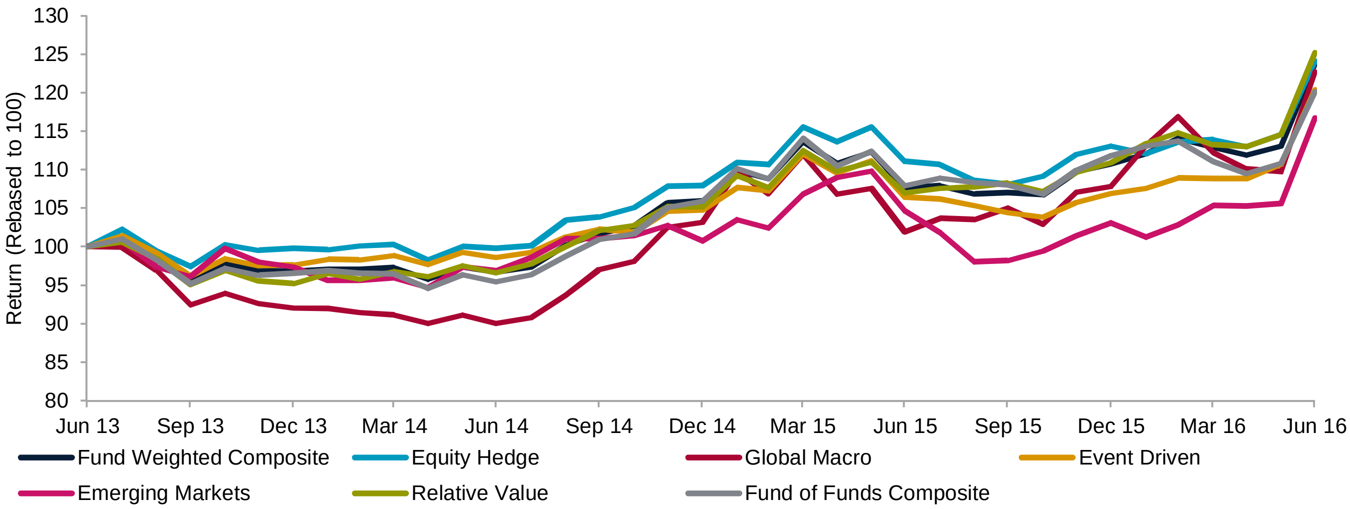
Source: Thomson Reuters and Bloomberg
Note: * subject to 1 month lag

MARKET SUMMARY CHARTS

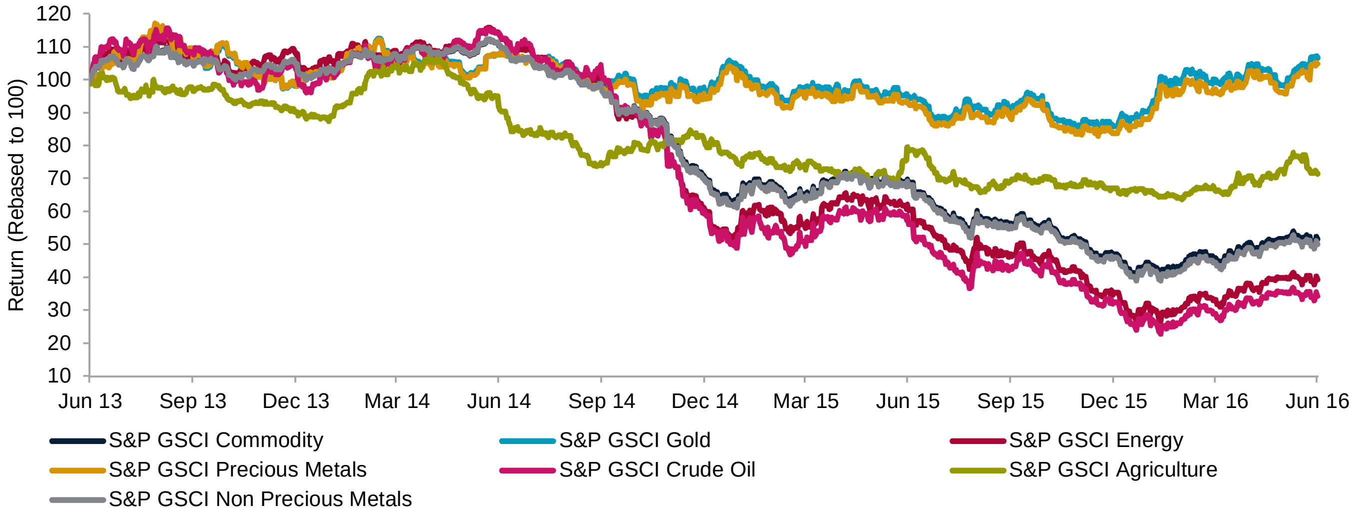
Market performance – 3 years to 30 June 2016



Hedge Funds: Sub-strategies performance – 3 years to 30 June 2016

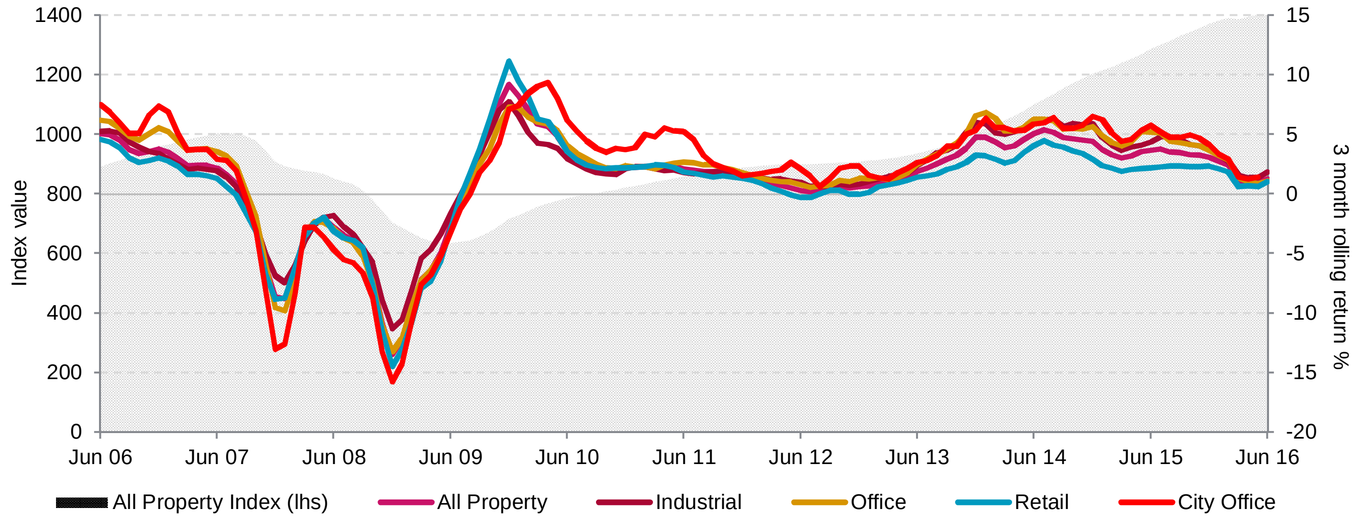


Commodity sector performance – 3 years to 30 June 2016

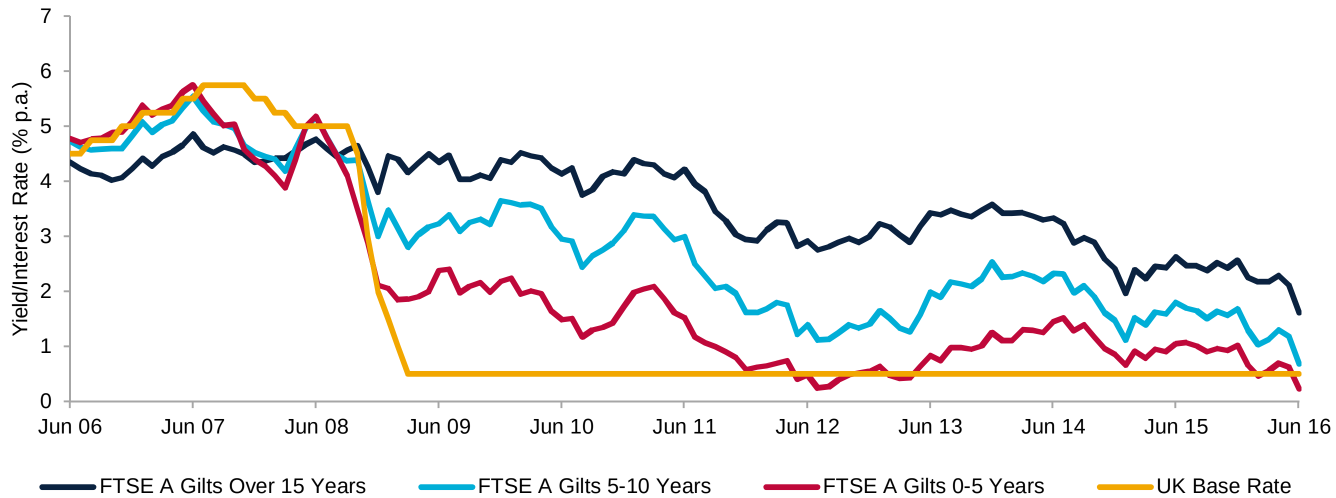


Source: Thomson Reuters

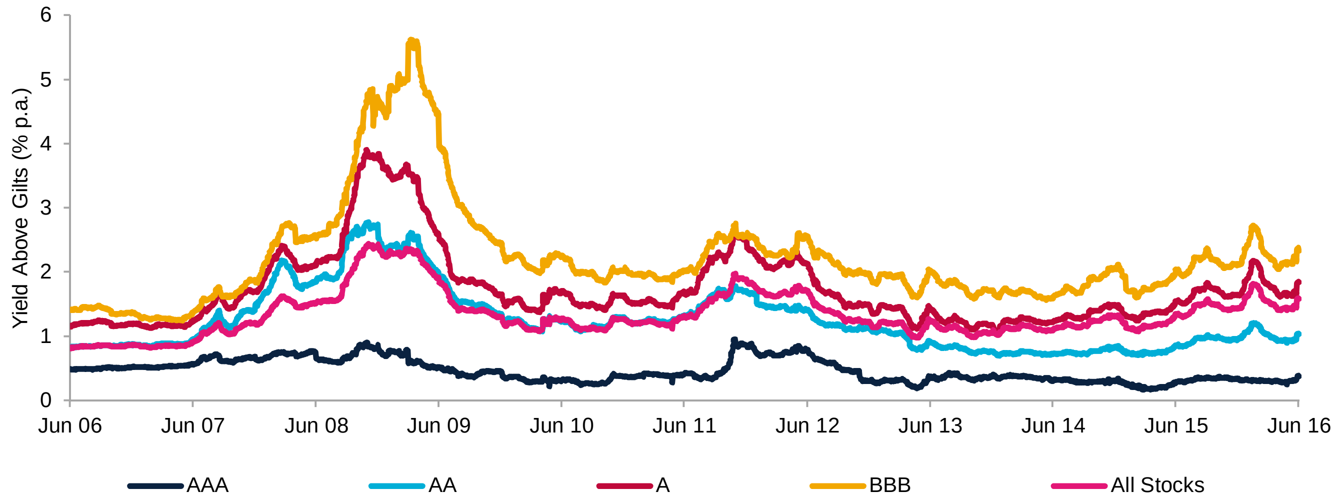
Property sector performance – 10 years to 30 June 2016



UK government bond yields – 10 years to 30 June 2016



Corporate bond spreads above government bonds – 10 years to 30 June 2016



Source: Thomson Reuters

2 ECONOMIC STATISTICS

Economic Statistics as at:	30 June 2016			31 March 2016			30 June 2015		
	UK	Euro[1]	US	UK	Euro[1]	US	UK	Euro[1]	US
Annual Real GDP Growth[2]	2.0%	3.0%	2.1%	1.8%	3.1%	2.0%	2.9%	2.4%	2.9%
Annual Inflation Rate[3]	0.5%	0.1%	1.0%	0.5%	0.0%	0.9%	0.0%	0.2%	0.1%
Unemployment Rate[4]	4.9%	10.3%	4.9%	5.1%	10.5%	4.9%	5.6%	11.2%	5.4%
Manufacturing PMI[5]	52.1	52.8	51.3	50.9	51.6	51.5	51.2	52.5	53.6

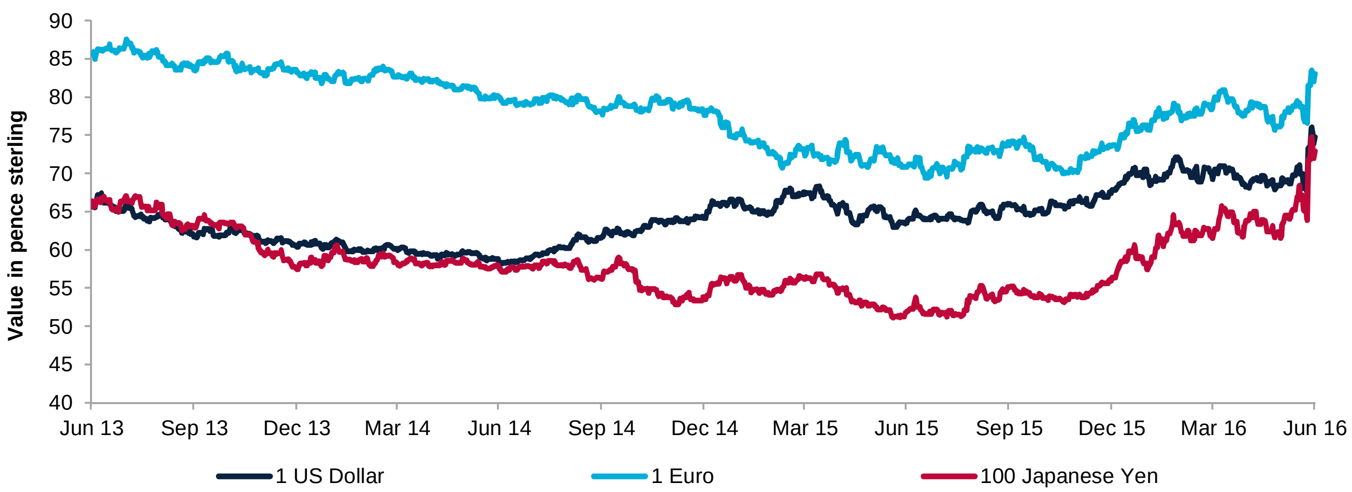
Change over periods ending:	3 months			12 months		
30 June 2016	UK	Euro[1]	US	UK	Euro[1]	US
Annual Real GDP Growth[2]	0.2%	-0.1%	0.1%	-0.9%	0.6%	-0.8%
Annual Inflation Rate[3]	0.0%	0.1%	0.2%	0.5%	-0.1%	0.9%
Unemployment Rate[4]	-0.2%	-0.2%	0.0%	-0.7%	-0.9%	-0.5%
Manufacturing PMI[5]	1.2	1.2	-0.2	0.9	0.3	-2.3

Notes: 1. Euro Area 19 Countries. 2. GDP is lagged by 1 quarter. 3. CPI inflation measure. 4. Euro unemployment is lagged by 1 quarter, 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 Jun 16	31 Mar 16	30 Jun 15	3 months	12 months
1 US Dollar is worth	74.81p	69.57p	63.58p	-7.0%	-15.0%
1 Euro is worth	83.10p	79.29p	70.85p	-4.6%	-14.8%
100 Japanese Yen is worth	72.92p	61.90p	51.96p	-15.1%	-28.7%

Exchange rate movements – 3 years to 30 June 2016



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

3 MARKET COMMENTARY

INTRODUCTION

There is one single event that took place a week before the end of the first half of 2016 elapsed, one which will bring uncertainty over a prolonged period and will likely dominate investment markets for weeks, months and potentially years to come, but lets hope not. This event, which is now seared into the minds of everyone in the UK is now commonly known to us all as Brexit.

On the 23rd June 2016 the British public voted to leave the European Union, the consequences of which have already had, and will continue to have, widespread political and investment ramifications.

The result surprised markets which had seemed to price in a remain vote, the bookmakers were indeed nigh on certain that the UK would vote for remain with Brexit being priced at 12/1 - how wrong they were.

The Pound (Sterling) fell immediately by 10% against the US Dollar, the currency's highest intra day fall since 1985. UK Equity markets initially fell sharply and, by 9am, Prime Minister David Cameron had announced his resignation. Mr Cameron announced that the new Conservative leader would not be in place until the autumn and crucially he did not invoke Article 50 of the Lisbon treaty which would trigger a two year formal leaving process of the EU.

This then led to jostling for position and the expected internal fighting within the Conservative party to ultimately become Prime Minister until 2020, barring an early General Election call. Boris Johnson surprisingly announced that he will not stand but his fellow leave campaigner Michael Gove would. There remains a real and understandable lack of willingness to press the button on Article 50. Perhaps 'Rule Britannia, Britannia waives the rules' will be serenaded at the last night of the proms in September this year.

The political fallout was not limited to the Conservative party, the majority of the shadow cabinet resigned after Shadow Foreign Secretary, Hilary Benn, was sacked by Jeremy Corbyn after he questioned the Labour leader's leadership.

From an investment standpoint, for UK investors, Sterling's fall was very important in determining how portfolios ended the year, something we will discuss in following sections of this review.

Some interesting decisions lay ahead, from an investment and political perspective, many of which will affect and impact the state of both the union of the EU and potentially the very union of the United Kingdom itself.

Uncertainty is definitely present in abundance and markets do not traditionally like uncertainty, however equity markets did rebound to end the half year upwards of the post Brexit decision lows.

UNITED KINGDOM

- Benjamin Disraeli once said 'Action may not always bring happiness; but there is no happiness without action'.
- The people of Britain have spoken and voted by a majority of 51.9% to 48.1% to leave the EU, with the turnout high at 72.2%. Although the vote is not legally binding it is, no doubt, a call for action. Something which has definitely not occurred as yet and the UK has entered a state of limbo. The UK's exit has to be negotiated with the remaining 27 members of the EU and ultimately has to be approved by all of them. In order to start this official process the UK must tell the EU that it is withdrawing under Article 50 of the Lisbon Treaty of 2009. Something David Cameron chose to defer to his successor in his resignation speech. Only once this declaration has been made does the formal negotiation clock start ticking and full exit should be achieved within two years.

- Given the political fallout explained in the introduction, there is widespread uncertainty as to the decisions that will be taken and when. An immediate reaction to shore up UK assets came from the Governor of the Bank of England, Mark Carney, who explained that the bank had ‘extensive contingency plans’ to handle Britain’s decision to leave the EU. Mr Carney immediately confirmed that he had made £250bn available to calm markets. He then went further to hint that interest rate cuts are potentially on the horizon together with a further round of quantitive easing.
- The reaction in the UK equity market was immediately harsh however the falls were not indiscriminate. There was a real distinction between those companies that are domestically focussed from those that operate largely overseas or rely heavily on exports. Many companies that fall into the latter category are large multinationals that are big enough to be in the FTSE 100, companies such as BP, AstraZeneca, Rio Tinto and GlaxoSmithKline. These companies would benefit from a weaker pound and were largely untouched by the Brexit fallout. For those domestically focussed companies, such as RBS, Taylor Wimpey and Lloyds, they were hit hard and fast. The same can be said for the much more domestically focussed FTSE 250 which is the next tranche of companies underneath the FTSE 100. This resulted in the FTSE 250 posting a significantly negative return in June of -5.1% versus the FTSE100 return of 4.7%.
- Sterling weakness is not all positive; there are real concerns about the knock on effects to UK inflation. A weaker Sterling leads to a potential for imported inflation, overseas goods become more expensive when they are exported and the UK could see prices rise. This, together with oil price rises, could lead to inflation creeping higher, giving the Bank of England a huge quandary with regards to interest rates. Should they cut rates to support economic growth or raise rates to stave off inflation? A UK recession remains a concern as businesses delay or even cancel plans to invest into the UK in the light of Brexit led uncertainty.

EUROPE EX UK

- Europe had a relatively tough year returning negative returns in Euro terms over the past twelve months, but positive in Sterling terms, following the post Brexit fall.
- The area struggled in the aftermath of the EU referendum result and suffered deeper falls than the UK market in the initial panic. The irony of Brexit is that the UK, having retained its own currency, can partially relieve pressure through a cheaper currency, something the Euro area could not use to soften the blow.
- Europe does however have other countries to concern itself with and there is a possibility that Brexit precipitates a return to crisis in the Eurozone periphery. Italy, Greece and Portugal have challenged economies and electorates that are similarly disillusioned. Questions will therefore be asked as to whether the European Union can stay intact and survive in a post Brexit world.
- The European banks remain in a position where they would struggle should the region turn to recession, particularly in the aforementioned periphery. Central bankers may also step in with additional stimulus measures through further negative interest rates and potentially more quantitive easing but these powers are yielding less and less.
- It is unlikely that the European economy will escape completely unscathed however markets have dropped significantly.

NORTH AMERICA

- Brexit has a global reach and impacts can be seen from market reactions across the globe. US equity markets fell alongside others in the aftermath of the EU referendum vote but, like their UK counterparts, rose to end June stronger.
- Fears over Brexit have led to calls for US interest rate rises, previously predicted to occur once and perhaps twice later this year, to be pushed out into 2017 and potentially 2018.
- There is a concern that US equity markets had risen too strongly in 2015 and that Q1 2016 earnings season would be poor. That did not occur and indeed many companies beat their respective market forecasts. How

much of this was masked by the strength of the US Dollar remains to be seen however this strength in the first quarter of 2016 earnings led to few downgrades in the second quarter.

- Consumer sentiment remains strong in the United States however department stores struggled, reflecting the continuing move to online shopping. Energy stocks have grown in strength from a very low level on the back of the price of oil once again passing, and staying over, $50 per barrel (Brent).
- May's job data was shown to be weakening, however the average hourly wage grew. Janet Yellen indicated that there were four areas of uncertainty prevailing in today's market scenario, these being inflation, productivity, slower overseas demand and overseas risk. Inflation remains under the Federal Reserve's target and GDP growth, for the first quarter of 2016, was revised upwards to 0.8% from 0.5%.
- The US equity market, following its post Brexit rise, had led to the market being extremely keenly valued on a price-to-earnings basis and the fall in Sterling against the Dollar has undoubtedly helped our clients' investments in this area.
- With an election due on November 8th this year, political ramifications will also be high on the agenda in the US. Aside from any major turn of events, Donald Trump and Hilary Clinton will fight to be the next President of the United States, the result of which will have definite economic and investment implications.

JAPAN

- Whichever way the Japanese authorities turn, their policies appear to have only one effect, a rise in the value of the Yen. Unfortunately this is the exact opposite of what they are looking to achieve.
- Japan relies heavily on exporting and hence a strong Yen is not at all in its interests. This does however help foreign investors that receive a currency uplift on their investments. The Yen spiked upwards quickly on the back of the Brexit vote. The country was already reeling from weak demand from both home and abroad, particularly from emerging markets where demand is weak and providing a significant headwind.
- Retail sales are still falling and combined with sluggish growth in wages, this puts added pressure on Japanese Prime Minister Shinzo Abe to roll out more stimulus.
- Abe has also urged the Bank of Japan to ensure they provide ample funds to the market to prevent any credit squeeze and for Finance Minister Taro Aso to keep a very close eye on currency moves and to respond flexibly to market developments in coordination with the G7 economies.
- The Yen has undoubtedly seen a rush of money as it is seen as a safe haven in a period of uncertainty. Japan has responded by saying that unilateral Yen selling intervention could not be ruled out to counter excess speculation.
- Concerns remain that the firepower available to the Bank of Japan is running dry as it plans once again to potentially expand its already massive monetary stimulus in an attempt to re-boot the economy.

ASIA PACIFIC EX JAPAN / EMERGING MARKETS

- 'China's GDP growth has slowed with a first quarter figure of 6.7%, the slowest since the start of 2009. This may appear negative but there are signs that the economy is finally stabilising.
- Stimulus has once again been utilised in the country to ensure that the world's second largest economy didn't slow further. This level of growth would, of course, be very welcome in other global economies but this is all relative in terms of valuations.
- The country has done well so far in converting the economy from export dependent to a domestic consumer and service led powerhouse. The road is still long though and this transformation will take time.
- As mentioned in the last review, and it is worth restating, the Renminbi is now measured against a basket, rather than just the US dollar, but is still significantly overvalued. There is a real risk of a formal, major, devaluation which would export deflation to the rest of the global economy. This would almost certainly lead to further falls in commodity prices and a possible repeat of the currency wars in Asia last experienced in the late 1990s.

- Asia and Emerging markets had a negative year in real terms but again sterling came to the rescue for the UK investor.
- Non-Asian markets continued to struggle with a strong Dollar and falling commodity prices. These two headwinds combined made index investing extremely dangerous, where commodity exposure is high.
- Chinese officials have cut interest rates repeatedly over the last two years and spent significant amounts of money on infrastructure projects. This doesn't help to cut the reliance on investment but it does help keep employment up in an ever increasing demand economy. China's exports have nonetheless grown in recent months and factory purchasing managers surveys have rebounded strongly.
- The IMF has recently cited China as one of the few global bright spots thanks to its resilient consumer spending and thriving service industries.

FIXED INCOME

- The fixed income market has experienced a strong six months and an even stronger full year. Volatility however persists across the wide spectrum of the fixed income asset class. Despite the US interest rate rise in December 2015, market events have led to thoughts that interest rates in the developed world will be lower for longer. Emerging Market debt and 'high yield' bonds (generally known as 'junk'), which had a poor end to 2015, rallied strongly in the last six months.
- Brexit risks have led investment grade debt to their lowest yields in history, especially US Treasuries, UK Gilts and German Bunds, which are now trading at such low yields that they are firmly seen as 'safe havens' despite a potentially inflationary backdrop. As mentioned in previous reviews, global tensions still persist, particularly in the Middle East, however on the plus side the dangers of interest rate rises seem to have abated given concerns over global economic growth.
- Valuations and liquidity both remain a challenge in all markets. Concerns still remain over the high yield market where a large amount of bonds issued by US energy companies are at risk of default, particularly given the current oil price, which puts additional pressure on the asset class.

ALTERNATIVES

- Hedge Funds (in sterling terms) returned 9.7% over the quarter, which was primarily due to a strengthening of the dollar against Sterling as hedge funds returned 2.0% in US Dollar terms. Emerging markets were the strongest strategies, returning 10.8%, whilst Equity Hedge returned 9.0% and were the worst performing strategies during this period. Over 3 years however, Relative value were the leading strategies with a return of 7.8% p.a. Emerging markets strategies had the worst returns over 12 months, returning 11.5%, whilst Global macro was the strongest during this period, returning 20.4%. Hedge fund strategies with exposure to global equities produced strong gains at the end of the quarter as equities reversed steep losses from the first half of the quarter.
- UK commercial property returned 1.3% over the quarter, down from 3.7% recorded in the same period last year. The positive return over the quarter was mainly due to the rental income generated by the properties. Industrials and city offices were the leading sectors over the quarter returning 1.8% and 1.4% respectively. Meanwhile, the retail sector continued to lag behind returning 1% over the same period. Yields expanded marginally over the quarter, as capital growth remained largely flat in June.
- Commodity markets continued their upward trajectory sustaining the rebound from their low point in January as market sentiment began to improve. Energy was the leading sector as prices pushed the index up by 19%. The GSCI crude oil index increased by 18.9% over the quarter due to strong demand and supply disruptions in Nigeria, Canada, Iraq, Kuwait and Libya. The Agriculture sector increased over three consecutive months, as prices were supported by flood related crop losses in South America, a shortfall in production and strong demand from China. Precious metals prices rose 8% on the back of strong investment demand, a weaker dollar, weak economic data from the US and the Brexit result leading to investors seeking safe haven assets. Silver led the way, up 13%, Platinum rose 10% and Gold increased by 7%.

CONCLUSION

It remains far too early to fully understand how the EU referendum decision will affect investments with any certainty. There are far too many unknowns out there and markets have appeared to have weathered the storm relatively well in the very short term. Things are undoubtedly moving quickly and there appears to be more political and economic consequences that are yet to unfold.

Sterling's fall has had massive implications on portfolios and their constituent parts. Being globally exposed has helped to protect portfolio valuations.

Inflation is a real concern and the decision by the Bank of England and other central banks will be watched closely. A Technical recession, (two quarters with negative GDP growth) could become a reality particularly if investment in the UK is held back for a prolonged period of time.

It will also be interesting to see if global demand for oil will be retained and the current price of $50 per barrel maintained.

4 INDICES USED IN THIS REPORT

Asset	Index
Growth Assets	
UK	FTSE All-Share Index
Global Developed	MSCI World Index
USA	FTSE USA Index
Europe	FTSE AW Europe (ex UK) Index
Japan	FTSE Japan Index
Asia Pacific (ex Japan)	FTSE AW Asia Pacific (ex Japan) Index
Emerging Markets	MSCI Emerging Markets Index
Frontier Markets	MSCI Frontier Markets Index
Property	UK IPD Monthly Property Index
Hedge Funds	HFRI Fund Weighted Composite Index
Commodities	S&P GSCI TR Index
High Yield	Bank of America Merrill Lynch Global High Yield Index
Emerging Markets Debt	JPM EMBI Global Diversified Composite Index
Senior Secured Loans	Credit Suisse Western European Leveraged Loan Index
Cash	IBA GBP LIBOR 1 Week 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 (15yrs)	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	All Items Retail Price Index (NADJ)
Price Inflation – CPI	All Items Consumer Price Index (Estimated NADJ)
Earnings Inflation	Average Weekly Index (Whole Economy excluding Bonuses)
Exchange Rates	
USD/EUR/JPY vs GBP	WM/Reuters 4:00 pm Closing Spot Rates

Notes: All the indices above are denominated in Sterling

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