Government Actuary's Department

2020 Issue 1 – January

Investment Bulletin

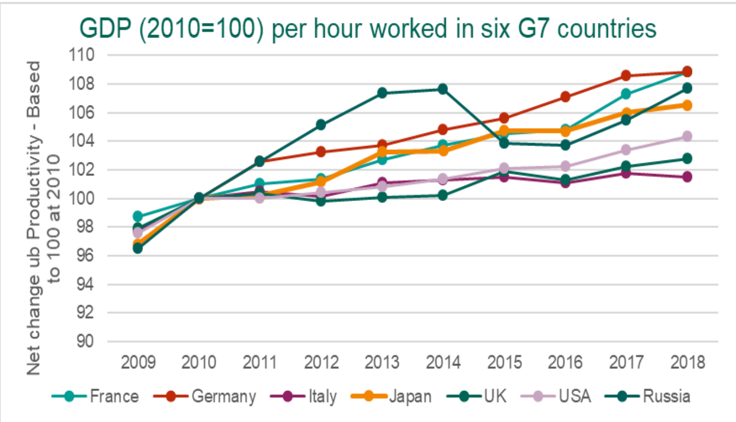
A look back on 2019

2019 ended on a relatively positive note, especially when compared with the same time last year. There is hope of a global growth pickup, trade tensions have lessened, and central banks have reaffirmed maintaining ultra-low interest rates. Financial volatility is subdued, in the wake of positive 1-year returns across many asset classes.

The continuation of the 18-month-long trade war between the US and China had increased the risks of a global recession. However, the 2 countries have now announced a preliminary trade deal, which reduces some US tariffs in exchange for more Chinese purchases of American products. While this is positive step forward, there are still some remaining issues to be resolved. The uncertainty surrounding the trade war had hurt businesses and weighed on the global economy. Recession worries peaked in August when the US yield curve inverted (2 year rates above 10 year rates) - yield curve inversions have in recent years preceded US recessions.

The outlook for 2020 is looking a bit brighter, with hopes on continued softening of trade tensions between the world's 2 largest economies. The result of the UK election means Brexit uncertainty may finally be on the way out. Amid ongoing criticism of negative interest rates across Europe, Sweden's central bank is expected to hike to zero from -0.25%, after 5 years of sub-zero rates.

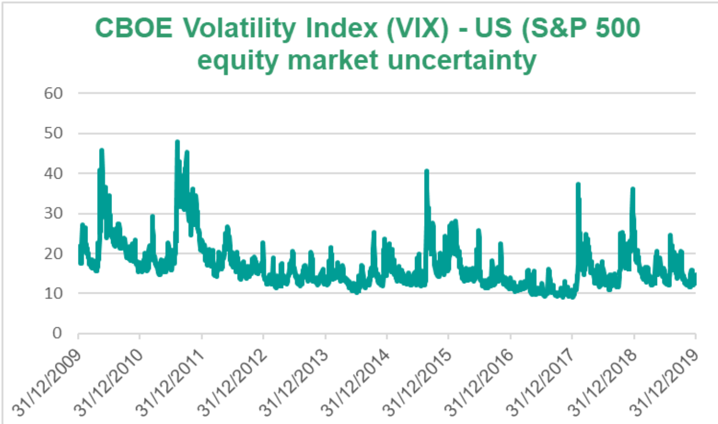
Productivity



Source: OECD Compendium of Productivity Indicators 2019

Productivity rates slightly improved over the year in all G7 countries, apart from Italy, which saw a small decline. The average productivity growth in the UK over the last 5 years has been 0.5% p.a. The UK experienced a slower productivity growth of 0.5%, compared to 1.0% the previous year.

Market volatility



Source: Yahoo Finance

The VIX is a market index that represents the market's expectations for S&P 500 index volatility over the coming 30 days. It provides a measure of market risk and investors' sentiments and is known as the 'Fear Gauge' or the 'Fear Index', as it tends to increase during period of uncertainty. The movement of the VIX this year shows a trend of rising bottoms but appears to have met a resistance level in upper 20s.

Forecasts

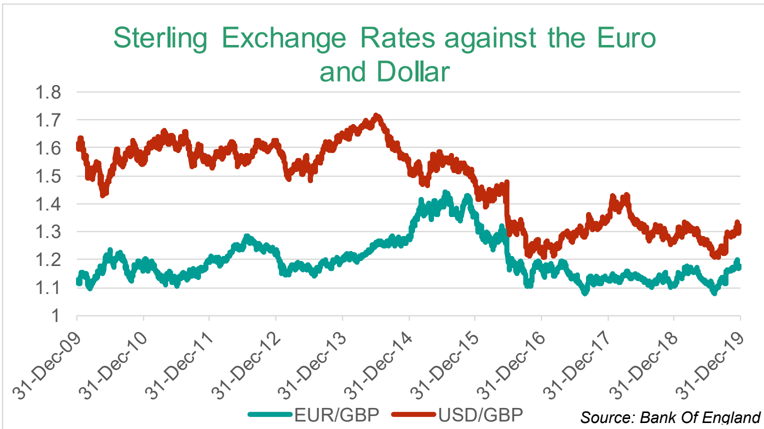
Headline economic forecasts for the UK

Forecasts	2019	2020
GDP growth	1.3	1.1
CPI	1.6	1.9
RPI	2.2	2.6
LFS Unemployment Rate	3.9	4.1
Current Account	-87.7	-76.6

Source: Forecasts for the UK economy: a comparison of independent forecasts, HM Treasury December 2019

While UK GDP growth was volatile over 2019, it has slowed materially – the weakest outturn since 2009, as Brexit-related uncertainties and weaker global growth weighed on spending. CPI inflation is projected to be near the Bank of England's 2% target until the end of the year with the expectation that the Bank of England will keep interest rates on hold until the situation on both Brexit and the global economy is clearer.

Exchange Rates



The pound fell to a 10-year low back in August, following further Brexit uncertainty, and a change of Prime Minister at the end of July. With the Brexit deadline extended from October to January 2020, and decreasing chances of a no-deal Brexit, the pound gradually rose for the rest of the year. The pound against the euro increased over the year by 5.5% since last December. The pound against the US dollar, followed a similar pattern showing the recovering pound, but it is still some way below the $1.5-1.7 trading range prior to the 2016 referendum.

January 2020

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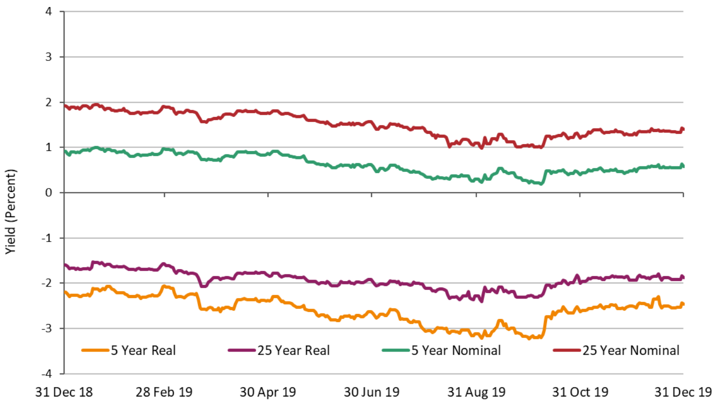
This month in brief

December provided a positive return capping a strong calendar year for the UK equity market. The market surged sharply on the news of a Conservative majority government. This was improved by the prospect of an end to the period of political impasse and greater clarity on the UK's exit from the European Union. The value of sterling proved volatile over the course of the month but increased rapidly on the election result pushing sterling to $1.33 and €1.19 to the pound. However, these gains were then reversed in the following weeks as the market re-focussed on the possibility of a 'no-deal' exit from the EU at the end of 2020.

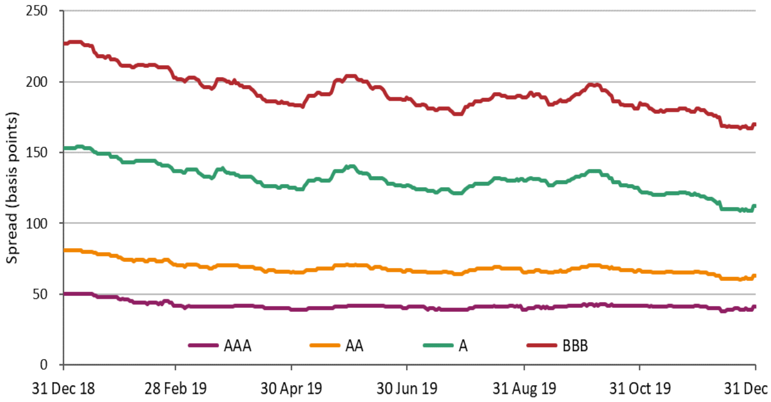
Bank of England's Monetary Policy Committee voted to retain the UK base interest rate of 0.75%. Andrew Bailey, Head of the Financial Conduct Authority, was appointed the new Governor of the Bank of England and will be assuming the role from March 2020. All 7 of the UK's major lenders passed the BoE's annual stress test, suggesting that they are robust enough to withstand a financial crisis.

UK retail sale figures were disappointing, they fell despite consensus expectations of an increase. There was also a sharp decline in the Purchasing Manager's Index for the manufacturing sector which fell to 47.5, a figure signalling a contraction in economic activity. The Nationwide House Price Index saw a 0.1% increase in December leading to an annual increase of 1.4% since December 2018.

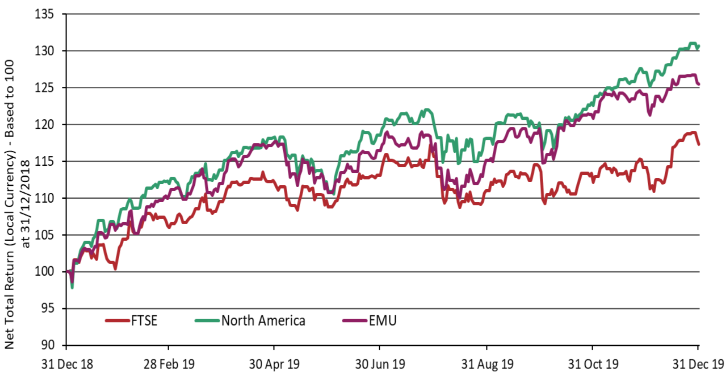
Real and nominal yields stable



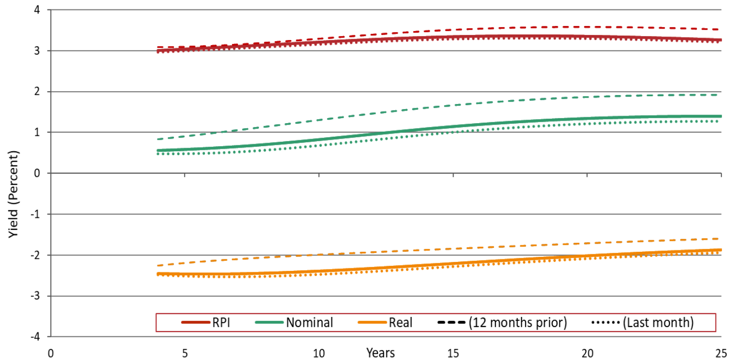
Credit Spreads tighten, particularly for the lower rated BBB credits



UK Equities have a strong end to the year



RPI Inflation breakevens and yields stable on the month. Down on the year, particularly long dated gilts



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