Monthly Economic Update

December 2015

FOR PROFESSIONAL ADVISERS ONLY

	Index Level 31 Dec 15	% Change December	% Change 1 Year
FTSE All Share £	3444	-1.3%	1.0%
FTSE 100 £	6242	-1.7%	-1.3%
MSCI World $	1663	-1.7%	-0.3%
S&P 500 $	2044	-1.6%	1.4%
MSCI Emerging Markets $	794	-2.5%	-17.0%
	Index Level 31 Dec 15	**Index Level 30 Nov 15**	**Index Level 31 Dec 14**
UK 10 Year Gilt Yield %	1.96	1.83	1.76
GBP/USD	1.47	1.50	1.56
GBP/EURO	1.36	1.42	1.29
Oil - WTI $	37.0	41.7	53.3
Gold $	1061	1065	1185

Source: Bloomberg

- The first US interest rate hike since 2006, underwhelming European and Japanese stimulus extensions and tumbling commodity prices held markets on edge throughout December. These combined to unsettle investor sentiment and markets reacted negatively to perceived inaction by some central banks. The end result was that most developed equity markets ended December lower however market rallies through the majority of the second half of December stemmed losses. The UK 10 year gilt yield increased from 1.83% to 1.96% as investors shied away from sovereign bonds and priced in higher interest rates.
- Early in December investors grew cautious over the potential impacts of a potential upcoming US rate rise, leading to falling equity prices. These fears were exacerbated alongside commodity price falls, their impact on global inflation which is at near zero levels and what this indicates about the state of the global economy.
- As widely forecast, the Federal Reserve (Fed) announced on the 16th December it is to increase interest rates for the first time in nearly a decade and in doing so brought an end to the period of zero interest rate policy. Fed chair Janet Yellen indicated that the initial rise will be followed by a period of gradual tightening. The Federal Open Market Committee voted unanimously to increase the target range for the federal funds rate by 25 basis points, moving the range from 0-0.25% to 0.25%-0.5%. Markets initially reacted positively to the news, with risk assets rallying.
- However, gains were short lived with US equity markets sliding sharply lower later as investors contemplated the effects of a rising US dollar and the rate at which monetary conditions are likely to be tightened. Short term yields increased following the announcement and the US dollar rallied by over 1% in the week of the announcement. High yield spread markets in the US endured turmoil and nearly reached 700 basis points, a level not seen since summer 2012.
- Since the Fed lifted US interest rates there has been some mixed macroeconomic data reported emanating from the States. However, non-farm payroll data showed the US added 211,000 new jobs in November, ahead of analysts expectations.
- Minutes from the Bank of England's Monetary Policy Committee meeting showed policy makers voted eight to one in favour of leaving interest rates unchanged at 0.5%, with expectations that inflation will remain benign and wage growth will plateau. The UK manufacturing purchasing managers' index (PMI) fell in November to 52.7 from 55.2, signaling that manufacturing is expanding but at a slower pace. The data from Markit also showed prices are falling sharply, which combined with slowing growth will keep inflationary pressures subdued and gives the Bank of England more leeway in their timing of raising interest rates.
- European markets endured a volatile month following the announcement of alterations in the European Central Bank's (ECB) monetary stimulus program. The ECB cut its deposit rate by 10bps to –0.3%, extended its quantitative easing program until at least March 2017 and increased the list of eligible securities it can buy. However, market participants had anticipated an increase in the amount of monthly bond purchases, which the ECB did not deliver on and following the announcement the euro spiked, European equities tumbled and bond yields increased as investors shunned the assets.
- However, European government bond yields still remain subdued with a large portion in negative yield territory. Mario Draghi moved to calm markets, explaining there was no limit to what the ECB could do to boost growth and encourage inflation. European equities were boosted late in the month as robust PMI readings across Europe combined with a strong reading for German business confidence.
- Investors were generally disappointed by the Bank of Japan's adjustment to their quantitative easing program. The central bank did not increase the size of asset purchases, however it did tweak the program to include ETFs and REITs. Japanese equities underperformed global peers following the announcement.
- Chinese PMI data recorded its lowest reading in three years as the economy remains fragile. However, Chinese equities enjoyed a strong rally as investors bet that Chinese authorities will increase stimulus in the region to counter the difficult macroeconomic environment. The Chinese yuan is to be included in the International Monetary Fund's basket of reserve currencies in October 2016 largely at the expense of the weighting allocated to the euro. The yuan will join the basket at roughly 11%, with the euro's allocation dropping from 37% to 31%.
- Energy prices continued to slide, with oil prices touching levels they have not been since the financial crisis as WTI traded below $35 per barrel for the first time this decade. The price of oil continued its slide following no decision to cut production by the Organization of Petroleum Exporting Countries (OPEC) at its official meeting, despite evidence of oversupply and large inventories. Oil prices were also impacted as Iran vowed to increase production and exports, worsening the global oversupply which investors have speculated will continue to be fuelled by OPEC. Gold also fell to its lowest level since 2009.

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Funding Level Index Update

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MOBIUS LIFE

About the Funding Level Index

The Mobius Life SME Pension Funding Level Index reports the health of the UK's small and medium sized pension schemes, which make up the majority of employer-sponsored defined benefit pension schemes in the UK.

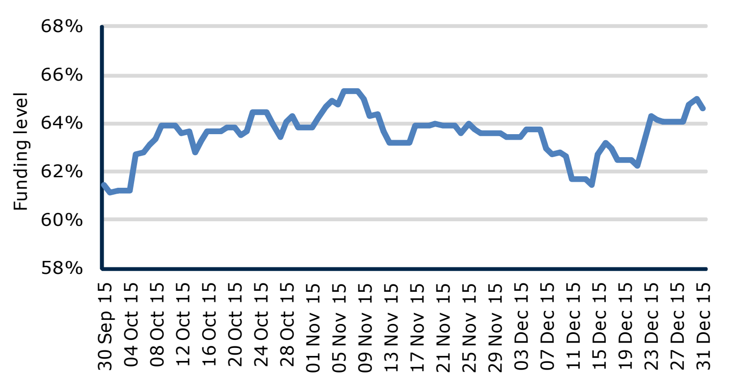
Mobius Life has been using the Index as an in-house tool since 2006 to illustrate the historical patterns of funding levels for a 'typical' small to medium sized pension scheme.

The index is based on a typical scheme allocation of 70% in equities and 30% in bonds. The last time the Index showed 100% funding level was in July 2007.

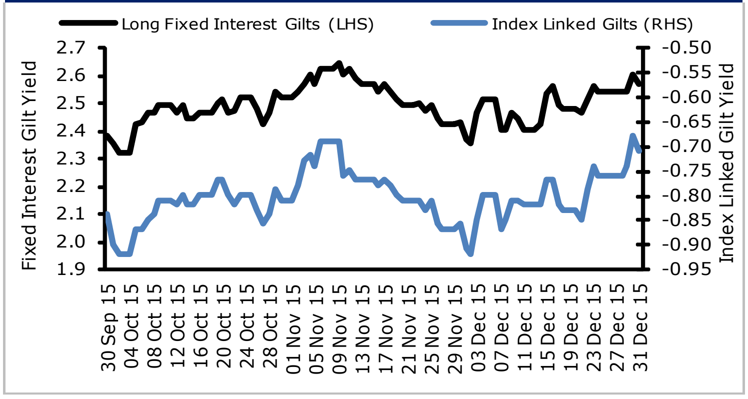
Funding Level Changes over 3 Months

Starting position (30/09/2015)	61.4%
Change due to asset returns	1.9%
Change due to change in liability value	1.3%
Ending position (31/12/2015)	64.6%

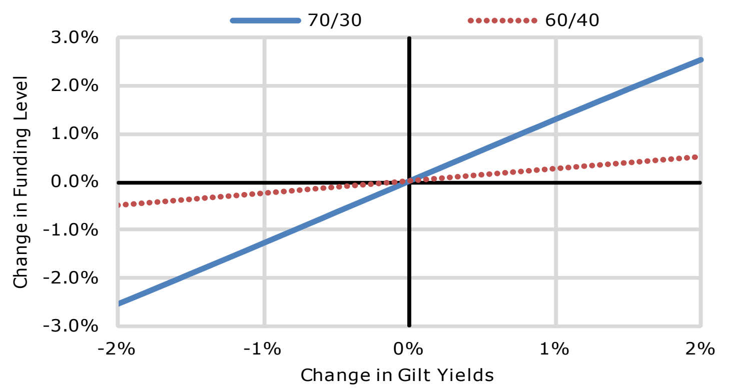
Funding Level Progression over the last 3 Months



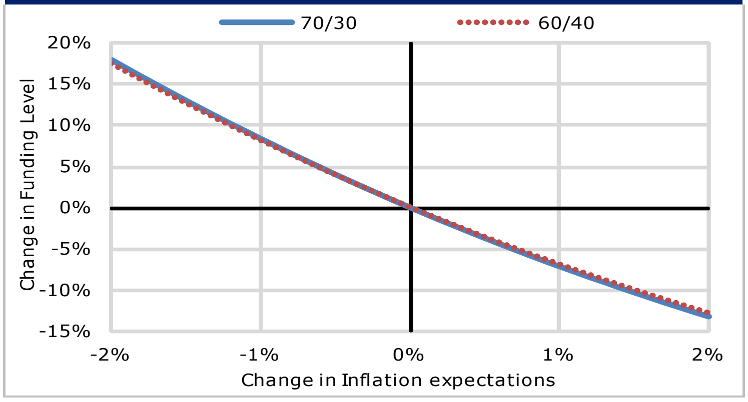
Gilt Yields over the last 3 Months



Effect of Change in Gilt Yields on Funding Level



Effect of Change in Inflation on Funding Level



Sensitivity Charts: Demonstrates the effect of a change to gilt yields or inflation expectations on the funding level, given the current level of 65%. The blue line reflects the scheme in the Mobius Life Funding Level Index, with assets split 70% Equity, 20% Fixed Interest Bonds and 10% Index Linked Bonds. Liabilities are: Fixed 30% and Index Linked 70%, duration for both is 20 years, and convexity for both is 250. As a proxy, the red dotted line in the charts represents a scheme with the same funding position and liability profile however with assets split 60% Equities, 28% Fixed Interest Bonds and 12% Index Linked Bonds.

Notes

The Index reflects the difference in movement of assets and liabilities, solely allowing for market movements. Deficit contributions, benefit payments and demographic changes are not included in the Index.

Standard Scheme Behind the Funding Level Index

Nature of liabilities:
Proportion related to index linked gilts (ILG) = 70%
Proportion related to fixed interest gilts (FIG) = 30%
Duration of liabilities = 20 years
Valuation return = 1.3% p.a. above gilts

Nature of assets:
Equity allocation = 70% (64% passive UK and 36% passive regional overseas). Bond allocation = 30% (33.3% ILG, 33.3% FIG, and 33.3% UK corporate bonds)

Contact Us

For more information about our Funding Level Index please contact our Client Services team using the details in the footer.

This document is based on Mobius Life opinion of the market, and whilst every effort has been made to ensure that the information contained is correct, Mobius Life cannot accept responsibility for any action arising as a result of the information.

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