

City Of London Corporation

Monthly Investment Analysis Review

October 2016



## City Of London Corporation

### Monthly Economic Summary

#### General Economy

Uncertain, unclear, unpredictable; just a few words used to describe Britain's post-Brexit economic outlook with the month of October continuing this trend. The collapse in Sterling was the key talking point for the month as unexpected events increased its volatility in currency markets. Theresa May's announcement on the final day of the Conservative Party Conference, that Article 50 would be "triggered no later than the end of March," caused the currency to fall by 1%. Philip Hammond added fuel to this fall by insinuating a "Hard Brexit" with departure from the Single Market being the desired route of action for Britain, followed by the potential to pursue a Customs Union once Brexit is complete. These announcements caused material levels of volatility in markets through the start of the month, even though official negotiations have yet to commence.

This initial tumble in Sterling was followed by the most detrimental event for the month; the 'Flash Crash' in the currency, where its value fell by 6% in 2 minutes, causing investors to worry that it could fall further. The crash was put partly down to a 'fat-finger trade' or faulty automatic trading algorithms. However, the factor to cause concern was that the currency never rebounded back to its original, pre-crash level. The currency is currently 16% less than it was pre-Brexit. One advantage of the depreciation is that it will help boost exports in the economy as the price of goods and services is relatively cheaper to those abroad. Nevertheless, greater inflationary pressure is another by-product of the currency depreciation. It is now widely anticipated that by 2018 inflation will be at least 3%, thus higher than the Monetary Policy Committee's target rate of 2%. This increase, combined with a materially better than expected performance of the economy, has led markets to conclude that an interest rate cut before the close of the year is highly unlikely.

The Purchasing Managers Index (PMI) figures were the first pieces of key data to be released for the month, providing investors with further insight into the economy's performance post-Brexit. On the whole figures were positive, with manufacturing activity rising to 55.4 from 53.4 in August, its fastest rate since June 2014. Likewise, the Construction PMI registered a rise, to 52.3 from 49.2 in August, beating the forecasted value of 49.0. The Services PMI also remained upbeat, despite it contracting slightly to 52.6 from 52.9 in August, even though the abnormally high August figure is believed to be a reaction to the unusually low July figure of 47.4. These figures broadly supported the case of not having an interest rate cut in November. All sectors of the economy saw activity readings in excess of 50, the level that separates "expansion" from "contraction".

Inflation figures for September were too early to reveal the effect which the 16% fall in Sterling had on the economy. Consumer-level inflation (CPI) for the year rose to 1.0%, its sharpest increase since November 2014, beating expectations of 0.9%. Furthermore, wholesale prices also increased, to 2.2% year-on-year. It was stated that the sharp increase was simply due to a rise in both clothing and fuel prices through the month. However, the Sterling impact will feed through, but typically lags by a number of months, so further upside movement is widely anticipated in the future. Elsewhere, figures showed that despite the labour market showing signs of it enduring the Brexit shock, growth in the labour market slowed. The claimant count rose by 700 to 776,400 in September with the unemployment rate remaining at 4.9%, despite an increase in the number of unemployed in the economy to 1.656 million in the three months to August.

Despite unexpected warm weather and higher prices for new clothing dampening demand towards the end of the third quarter, UK retail sales recorded its strongest quarter since late 2014. In the three months to September sales grew by 1.8% despite a disappointing 0.0% change on the month. On the year, sales were down from August's figure of 6.6% as data for September came in at 4.1%, lower than the forecasted 4.8%. Many economists fear that the knock-on effect from rising inflation in the form of rising prices, will heavily affect consumer demand in the economy as a result of the sharp decline in Sterling since the EU referendum; a factor which caused the consumer confidence GfK index to fall to -3 in October from -1 in September.

Public finances also added to Britain's list of problems as it showed a larger than forecasted deficit for September of £10.6bn, 14.5% higher than the deficit in the same month last year. Corporation tax receipts unexpectedly experienced its first fall since September 2009, with experts struggling to understand the reasoning behind the drop given other, more robust data releases. Therefore, the chances of Britain reaching its budget target for the year have all but disappeared after this release. However, current target levels are expected to be torn up at Chancellor Philip Hammond's first Autumn Statement in November. The more robust performance of the economy through the quarter was clearly reflected in the first estimate of Q3 Gross Domestic Product (GDP). This came in above both market and Bank of England expectations at 0.5% on the quarter, with annual growth at 2.3%. The breakdown revealed that while both construction and manufacturing activity declined, a strong performance from the services sector was the key driver. Looking ahead, with prices on the rise, there remain serious question marks as to whether this level of activity can be maintained.

Across the pond US employment growth unexpectedly continued to slow for September as the unemployment rate rose to 5.0% from 4.9% in the previous month. Despite non-farm payrolls rising by 156,000, it was still down from the revised figure of 167,000 for August. Fed Chair, Janet Yellen, has previously stated that sustainable job gains in the US economy should be at 100,000 monthly in order to remain consistent with population growth. On the other hand, Q3 GDP figures were upbeat for the quarter as it increased at 2.9% on an annualised basis, exceeding the 1.4% recorded in Q2. This strong rate was largely due to a 2.1% increase in consumer spending for the quarter, as well as a 10% rise in soybean exports. The figures increased expectations that the Federal Reserve would hike rates before the close of the year. However, uncertainty over the outcome of November's Presidential Election could still prove a key factor on what the central bank decides.

Data for the Eurozone showed that growth in the third quarter remained steady, as expected. According to Eurostat, GDP in the third quarter rose by 0.3% on the quarter and 1.6% on the year. Elsewhere, a "Flash" estimate for CPI showed that it rose 0.5% year-on-year in October from 0.4% in September. The combination of tepid growth and still scant levels of inflation lead many economists to forecast that the European Central Bank will extend its loose monetary policy, potentially at its December meeting.

Britain's future is a subject which no-one can confidently predict, which leads to turbulence in financial markets. What can be said is that the economic events set to be held in November have the potential to cause further fluctuations in financial markets. The Bank of England Quarterly Inflation Report and the Chancellor's Autumn Statement will provide an insight as to what the experts expect to happen in the UK over the coming months. Further afield, the spotlight will be on the US Presidential Election on the 8th of November and what ramifications this may have going forwards.

### **Housing**

House price growth continued to slow in September as the previous surge in values damped demand in the market, according to Halifax. On the month, values increased by 0.1% leaving the annual figure at 5.8%. This was down from 6.9% in August and the lowest figure since August 2013. Towards the close of the month, Nationwide shared a similar view as it reported that the housing market recorded its slowest annual price growth since January in October at 4.6%, down from September's figure of 5.3%. These figures combined lent some support to Theresa May's statement that government intervention is needed to repair the 'dysfunctional' housing market.

### **Forecast**

Capita Asset Services (CAS) did not alter their forecasts this month. Capital Economics altered their forecasts this month as a result of the recent volatility in the financial markets. It is mutually anticipated that another rate cut will occur in the last quarter of this year with CAS forecasting a potential hike occurring in the second quarter of 2018.

Bank Rate	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Capita Asset Services	0.10%	0.10%	0.10%	0.10%	0.10%
Capital Economics	0.10%	0.10%	0.10%	0.10%	0.10%

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## Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
MMF Aberdeen	93,500,000	0.37%		MMF	AAA	0.000%
MMF CCLA	10,000,000	0.29%		MMF	AAA	0.000%
MMF Federated Investors (UK)	70,100,000	0.35%		MMF	AAA	0.000%
MMF Federated Investors (UK)	4,200,000	0.31%		MMF	AAA	0.000%
ECF Federated Sterling Cash Plus Fund	5,000,000	0.48%		ECF	AAA	0.000%
MMF Invesco	81,400,000	0.40%		MMF	AAA	0.000%
MMF Invesco	1,300,000	0.33%		MMF	AAA	0.000%
ECF Payden Sterling Reserve Fund	55,000,000	1.10%		ECF	AAA	0.000%
MMF Standard Life	53,700,000	0.36%		MMF	AAA	0.000%
MMF Standard Life	8,600,000	0.33%		MMF	AAA	0.000%
ECF Standard Life Short Duration Cash Fund	5,000,000	0.85%		ECF	AAA	0.000%
Lloyds Bank Plc	31,000,000	0.25%		Call	A	0.000%
Nationwide Building Society	23,700,000	0.50%	25/07/2016	02/11/2016	A	0.000%
Nationwide Building Society	9,400,000	0.31%	05/08/2016	07/11/2016	A	0.001%
Barclays Bank Plc	39,000,000	1.00%	27/11/2015	28/11/2016	A-	0.005%
National Australia Bank Ltd	10,900,000	0.58%	09/06/2016	09/12/2016	AA-	0.001%
Svenska Handelsbanken AB	5,000,000	0.30%	15/09/2016	15/12/2016	AA-	0.001%
Svenska Handelsbanken AB	1,400,000	0.30%	15/09/2016	15/12/2016	AA-	0.001%
Barclays Bank Plc	36,000,000	1.03%	21/12/2015	21/12/2016	A-	0.009%
Lloyds Bank Plc	27,800,000	1.05%	22/12/2015	22/12/2016	A	0.010%
Lloyds Bank Plc	10,000,000	0.90%	01/04/2016	02/01/2017	A	0.012%
Australia and New Zealand Banking Group Ltd	5,000,000	0.26%	03/10/2016	03/01/2017	AA-	0.001%
Leeds Building Society	7,000,000	0.66%	20/06/2016	03/01/2017	A-	0.012%
Leeds Building Society	5,000,000	0.66%	20/06/2016	03/01/2017	A-	0.012%
Nationwide Building Society	25,000,000	0.88%	06/04/2016	06/01/2017	A	0.012%
Lloyds Bank Plc	14,600,000	0.50%	07/10/2016	09/01/2017	A	0.013%
Leeds Building Society	8,000,000	0.66%	27/06/2016	11/01/2017	A-	0.013%
Svenska Handelsbanken AB	18,600,000	0.32%	12/10/2016	12/01/2017	AA-	0.001%
Lloyds Bank Plc	1,800,000	0.50%	13/10/2016	13/01/2017	A	0.014%
Lloyds Bank Plc	2,700,000	0.50%	20/10/2016	20/01/2017	A	0.015%
Lloyds Bank Plc	5,700,000	0.50%	26/10/2016	26/01/2017	A	0.016%
Lloyds Bank Plc	3,200,000	0.50%	27/10/2016	27/01/2017	A	0.016%
Lloyds Bank Plc	1,200,000	0.50%	28/10/2016	30/01/2017	A	0.017%
Australia and New Zealand Banking Group Ltd	15,000,000	0.30%	31/10/2016	31/01/2017	AA-	0.002%
Lloyds Bank Plc	10,600,000	1.50%	01/02/2016	01/02/2017	A	0.017%
Santander UK Plc	100,000,000	0.65%		Call95	A	0.017%

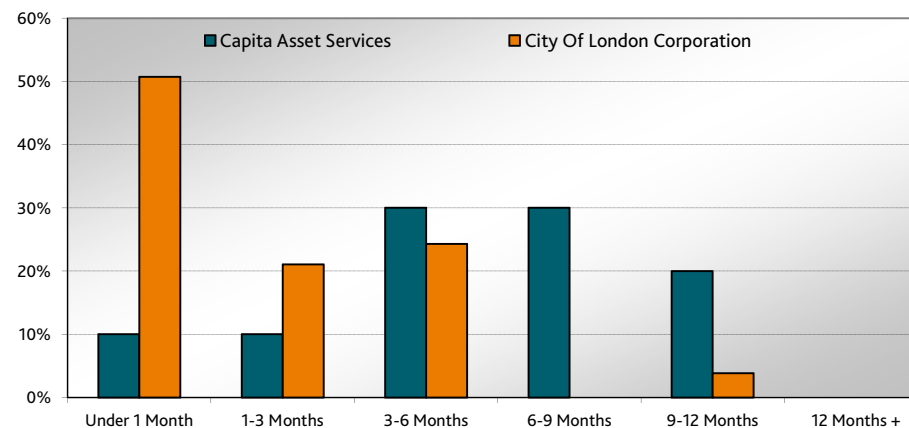
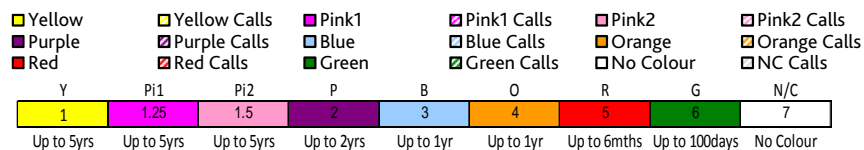
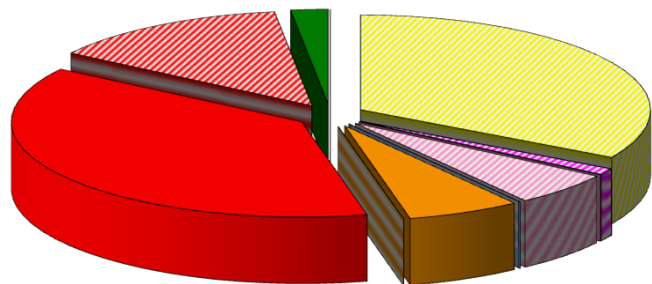
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### Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
Coventry Building Society	10,600,000	0.33%	04/10/2016	20/02/2017	A	0.021%
Coventry Building Society	5,300,000	0.33%	05/10/2016	27/02/2017	A	0.022%
Nationwide Building Society	6,700,000	0.39%	03/10/2016	03/03/2017	A	0.023%
Australia and New Zealand Banking Group Ltd	5,000,000	0.28%	05/09/2016	06/03/2017	AA-	0.002%
Coventry Building Society	4,100,000	0.37%	05/09/2016	06/03/2017	A	0.023%
Nationwide Building Society	4,300,000	0.42%	06/09/2016	06/03/2017	A	0.023%
Nationwide Building Society	5,300,000	0.36%	06/10/2016	06/03/2017	A	0.023%
Nationwide Building Society	19,400,000	0.50%	07/09/2016	07/03/2017	A	0.023%
Nationwide Building Society	3,800,000	0.43%	15/09/2016	15/03/2017	A	0.025%
Nationwide Building Society	10,200,000	0.44%	07/10/2016	24/03/2017	A	0.026%
Nationwide Building Society	5,000,000	0.43%	26/09/2016	27/03/2017	A	0.027%
Barclays Bank Plc	25,000,000	0.53%	30/09/2016	30/03/2017	A-	0.028%
Skipton Building Society	20,000,000	1.05%	22/04/2016	24/04/2017	BBB	0.072%
Nationwide Building Society	7,200,000	0.65%	30/08/2016	30/08/2017	A	0.056%
Lloyds Bank Plc	30,000,000	1.00%	03/10/2016	03/10/2017	A	0.062%
<b>Total Investments</b>	<b>£967,300,000</b>	<b>0.59%</b>				<b>0.010%</b>

## City Of London Corporation

### Portfolio Composition by Capita Asset Services' Suggested Lending Criteria



Portfolios weighted average risk number =

3.39

WARoR = Weighted Average Rate of Return

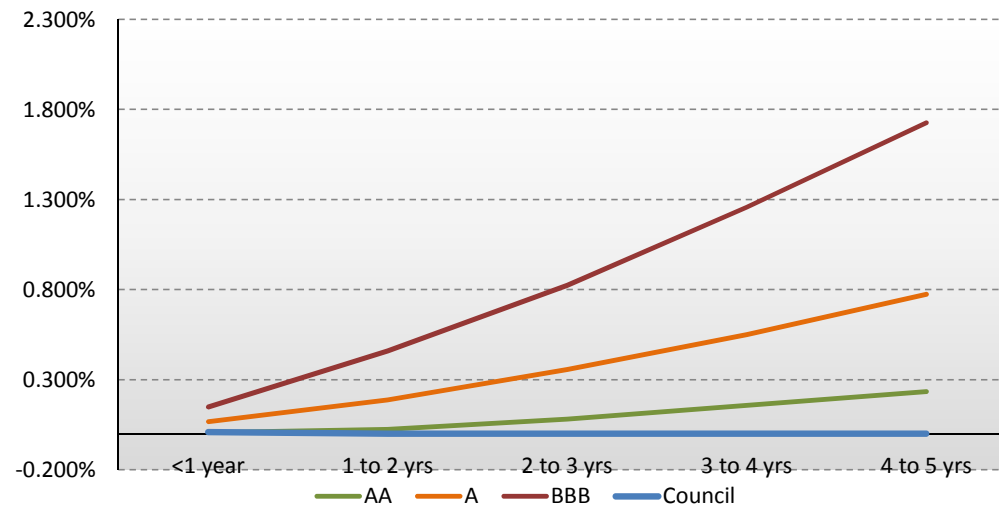
WAM = Weighted Average Time to Maturity

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs/ECFs	WAM	WAM at Execution
Yellow	33.37%	£322,800,000	100.00%	£322,800,000	33.37%	0.37%	0	0	0	0	0
Pink1	1.03%	£10,000,000	100.00%	£10,000,000	1.03%	0.67%	0	0	0	0	0
Pink2	5.69%	£55,000,000	100.00%	£55,000,000	5.69%	1.10%	0	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0	0
Blue	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0	0
Orange	6.30%	£60,900,000	0.00%	£0	0.00%	0.35%	72	116	72	116	116
Red	51.55%	£498,600,000	26.27%	£131,000,000	13.54%	0.69%	93	203	101	249	249
Green	2.07%	£20,000,000	0.00%	£0	0.00%	1.05%	175	367	175	367	367
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0	0
<b>Total</b>	<b>100.00%</b>	<b>£967,300,000</b>	<b>53.63%</b>	<b>£518,800,000</b>	<b>53.63%</b>	<b>0.59%</b>	<b>56</b>	<b>119</b>	<b>100</b>	<b>236</b>	<b>236</b>

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### Investment Risk and Rating Exposure

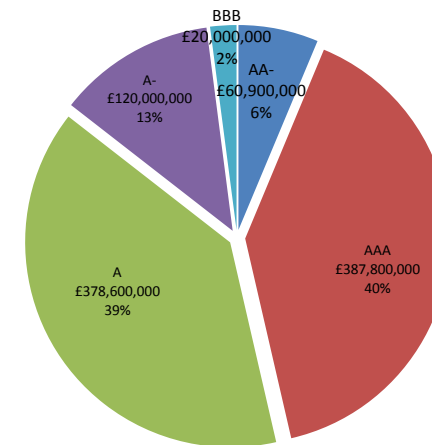
Investment Risk Vs. Rating Categories



Historic Risk of Default

Rating/Years	<1 year	1 to 2 yrs	2 to 3 yrs	3 to 4 yrs	4 to 5 yrs
AA	0.007%	0.024%	0.081%	0.158%	0.234%
A	0.067%	0.189%	0.356%	0.551%	0.775%
BBB	0.150%	0.460%	0.824%	1.257%	1.726%
Council	0.010%	0.000%	0.000%	0.000%	0.000%

Rating Exposure



#### Historic Risk of Default

This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It simply provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.

#### Chart Relative Risk

This is the authority's risk weightings compared to the average % risk of default for "AA", "A" and "BBB" rated investments.

#### Rating Exposures

This pie chart provides a clear view of your investment exposures to particular ratings.

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### Monthly Credit Rating Changes FITCH

Date	Update Number	Institution	Country	Rating Action
05/10/2016	1475	Wells Fargo Bank NA	U.S.A	Long Term Rating affirmed at 'AA', Outlook changed to Negative from Stable. Short Term Rating affirmed at 'F1+'.
14/10/2016	1479	Standard Chartered Bank	U.K	Long Term Rating affirmed at 'A+', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'F1'. Viability Rating downgraded to 'a' from 'a+'.



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### Monthly Credit Rating Changes MOODY'S

Date	Update Number	Institution	Country	Rating Action
06/10/2016	1476	Skipton Building Society	U.K	Long Term Rating affirmed at 'Baa2', Outlook changed to Positive from Stable. Short Term Rating affirmed at 'P-2'.
12/10/2016	1477	Danske Bank	Denmark	Long Term Rating upgraded to 'A1' from 'A2', Outlook changed to Positive from Stable. Short Term Rating affirmed at 'P-1'.

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### Monthly Credit Rating Changes S&P

Date	Update Number	Institution	Country	Rating Action
13/10/2016	1478	Credit Industriel et Commercial	France	Long Term Rating affirmed at 'A', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'A-1'.
19/10/2016	1480	Wells Fargo Bank NA	U.S.A	Long Term Rating affirmed at 'AA-', Outlook changed to Negative from Stable. Short Term Rating affirmed at 'A-1+'.
24/10/2016	1481	France Sovereign Rating	France	Sovereign Rating affirmed at 'AA', Outlook changed to Stable from Negative.
25/10/2016	1482	KBC Bank NV	Belgium	Long Term Rating affirmed at 'A', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'A-1'.
31/10/2016	1483	Macquarie Bank Limited	Australia	Long Term Rating affirmed at 'A', Outlook changed to Negative from Stable. Short Term Rating affirmed at 'A-1'.