CAPITA
Treasury solutions

Asset Services

City Of London Corporation

Monthly Investment Analysis Review

August 2017

Monthly Economic Summary

General Economy

The increasingly turbulent Brexit negotiations have, unsurprisingly, been the centre of attention for the Government last month and the turbulence has not stopped there. With the mixed bag of economic data throughout August, the Government and the Bank of England (BoE) are in the midst of a difficult juggling act.

The month kicked off with manufacturing activity data. The Markit/CIPS UK Manufacturing Purchasing Manager's Index (PMI) showed that the headline reading increased to 55.1 as the UK saw its 'biggest influx of new export orders since 2010', thus, exceeding the consensus of a move to 54.4. This increase in manufacturing activity was driven mainly by consumer goods producers in July, whilst the boom in exports was broad-based with more orders from Europe, East Asia, the Middle East and North America. There was also a slight pick-up in the Services PMI which rose to 53.8 in July from its June four month low of 53.4. On the other hand, activity in the construction sector dropped to an 11-month low. The dull outlook for the economy and the intensifying political uncertainty contributed to the UK Construction PMI falling to 51.9 from 54.8, which was much lower than markets had expected. Although construction only accounts for approximately 6% of the UK economic output, such figures still highlight a sector that is 'struggling to maintain momentum'. According to IHS Markit's Chief Business Economist, Chris Williamson, the manufacturing and services figures and the weak construction figures taken together suggest that the economy is growing at a steady, yet sluggish, quarterly rate of 0.3% - with demand dropping due to squeezed household budgets. British retail sales were also, as predicted, slower in July with consumers cutting back on purchases of most items other than food, further fuelling the worries about a fall in consumer demand.

The Consumer Price Index (CPI) unexpectedly remained unchanged in July at 2.6% due to a fall in fuel prices. There were signs that the squeeze on households' disposable income may be starting to level off as the rises in food prices, clothing and household goods were offset by a fall in fuel prices. Since the June referendum, Sterling has dropped 14% against a trade-weighted basket of major currencies leading the BoE to believe that this is the reason behind consumer-level inflation being above its 2 per cent target. Based on the BoE's previous experience with such a fall in Sterling at the beginning of the financial crisis, they expect CPI to remain above the 2% target for the next three years. Conversely, the inflation rate for raw materials dropped to 6.5% from 10% previously – the sharpest month-on-month drop since April 2012 and the lowest rate in a year.

The key dilemma facing the Bank of England's Monetary Policy Committee (MPC) in August was the tough balancing act between the anticipation of further increases in price pressures, due to the weakened pound, and declining consumer spending and inward investment. The background to the decision was inflation near a four year high, as Brexit took its toll on consumer spending power while growth was at its slowest pace since 2012. Despite some market speculation of a rate hike, the MPC voted 6-2 to keep the Bank Rate unchanged at 0.25%. As a result of the vote, the pound dropped by just under one cent against the dollar. BoE Governor, Mark Carney, did reiterate that the MPC may raise borrowing costs by slightly more than investors are currently forecasting over the next three years, or possibly within a year, thus hinting at a possible 2018 rate hike.

With regards to UK public finances, the UK posted its first budget surplus for any July since 2002 at £184 million compared to last year's deficit of £308 million (excluding state-controlled banks), with the figures being boosted by a 10% year-on-year rise in self-assessed tax payments.

Lethargic consumer demand, as a result of the weaker pound weighing in on spending power, also left the second estimate of Q2 GDP growth unrevised at 0.3% growth quarter-on-quarter and 1.7% growth year-on-year – the weakest start to any fiscal year since 2012. These figures are of stark contrast to last year where the UK economy was one of the fastest growing among the G7 nations. However, that growth was heavily reliant on robust consumer spending which is currently wavering. Prior to this release in the latter stages of the month, the BoE had already trimmed its growth forecast for this year to 1.7% from 1.9% during its August MPC meeting.

The unemployment rate in the three months to the end of June dropped to 4.4%– the lowest since 1975. However, tepid wage growth figures present a challenge for the Government as households are feeling the pinch of rising prices. Although inflation has eased slightly since May, prices are still rising faster than wages with overall wage growth "in real terms" falling by 0.5%. In response to this, the BoE cut its forecast for wage growth in 2018 and 2019 to 3% and 3.25%, respectively.

On the other side of the pond, there were further signs of tightness in the US labour market as non-farm payrolls increased by 209,000 jobs. This was much more than had been expected. The figures provided further credence to the view that the Federal Reserve will soon announce details of how it will shrink its large bond portfolio accumulated through the financial crisis to support the economy. Additionally, the unemployment rate fell to 4.3% and the labour force participation rate rose to 62.9%. However, similar to the UK, wage growth still lagged with average hourly earnings increasing by 0.3% despite the economy being close to full employment. Nonetheless, US Q2 GDP growth was revised up to 3% annualised in the April-June period from 2.6% previously, reflecting adjustments for robust consumer spending and strong business investment. However, sluggish wage growth, relatively soft inflation and little signs of fiscal progress, still suggest that the Fed will delay raising rates again until December this year.

A little closer to home, Eurozone Q2 GDP grew by 0.6% on the quarter, while the annual GDP figure was revised upwards to 2.2%. Economic growth was strongest in the Netherlands and Latvia, with Spain's economy also growing above average.

Housing

Nationwide reported that house prices rose for a second month in a row in July by 0.3% to an average of £211,671. Although this was slower than June's 1.1% jump, it was still greater than the figure a poll of economists had expected – a 0.1% drop in July. Halifax, conversely, reported slightly more pessimistic figures. The lender stated that house prices in the UK rose at their slowest rate in more than four years in the three months to July, as a consequence of the impact of inflation rising faster than wages. Halifax also reported that average house prices in the three months to July were 2.1% higher than a year earlier, down from a 2.6% increase in June's figures and lower compared to the growth of more than 8% in July last year. The housing market has significantly slowed down since the referendum, when house prices were almost growing by 10% a year.

Forecast

Neither Capita Asset Services (CAS) nor Capital Economics (CE) altered their forecasts this month. It is forecasted by CAS that a rate hike to 0.50% will occur in Q2 2019 followed by a further hike to 0.75% in Q4 2019. CE expects a hike in the bank rate to occur in Q2 2018 to 0.50% with further hikes forecasted in Q4 2018 to 0.75% and in Q2 2019 to 1.00%.

Bank Rate	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%
Capital Economics	0.25%	0.25%	0.25%	0.50%	0.50%

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Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
MMF CCLA	10,000,000	0.19%		MMF	AAA	0.000%
MMF Deutsche	12,500,000	0.20%		MMF	AAA	0.000%
MMF Federated Investors (UK)	5,000,000	0.54%		MMF	AAA	0.000%
MMF Federated Investors (UK)	20,400,000	0.21%		MMF	AAA	0.000%
MMF Invesco	57,400,000	0.25%		MMF	AAA	0.000%
Lloyds Bank Plc	5,800,000	0.20%		Call	A	0.000%
USDBF Payden Sterling Reserve Fund	55,000,000	0.91%		USDBF	AAA	0.000%
Santander UK Plc	100,000,000	0.60%		Call	A	0.000%
MMF Standard Life	5,000,000	0.67%		MMF	AAA	0.000%
MMF Standard Life	21,700,000	0.22%		MMF	AAA	0.000%
Kingston Upon Hull City Council	5,000,000	0.37%	01/06/2017	01/09/2017	AA	0.000%
Dundee City Council	5,000,000	0.37%	28/04/2017	06/09/2017	AA	0.000%
Leeds City Council	25,000,000	0.33%	16/06/2017	18/09/2017	AA	0.001%
Birmingham City Council	25,000,000	0.50%	24/04/2017	25/09/2017	AA	0.002%
North Lanarkshire Council	5,000,000	0.48%	24/02/2017	27/09/2017	AA	0.002%
Barclays Bank Plc	25,000,000	0.62%	03/04/2017	29/09/2017	A-	0.004%
Surrey County Council	25,000,000	0.35%	30/06/2017	29/09/2017	AA	0.002%
Lloyds Bank Plc	22,600,000	0.32%		Call32	A	0.005%
Lloyds Bank Plc	30,000,000	1.00%	03/10/2016	03/10/2017	A	0.005%
Barclays Bank Plc	36,000,000	0.74%	04/01/2017	04/10/2017	A-	0.005%
Lloyds Bank Plc	16,400,000	0.55%	04/04/2017	04/10/2017	A	0.005%
Suffolk County Council	5,000,000	0.48%	06/03/2017	06/10/2017	AA	0.002%
Lloyds Bank Plc	10,000,000	0.55%	12/04/2017	12/10/2017	A	0.006%
Australia and New Zealand Banking Group Ltd	5,000,000	0.34%	27/06/2017	27/10/2017	AA-	0.004%
Australia and New Zealand Banking Group Ltd	15,000,000	0.40%	03/05/2017	03/11/2017	AA-	0.004%
Lloyds Bank Plc	10,000,000	0.55%	03/05/2017	03/11/2017	A	0.010%
Coventry Building Society	20,000,000	0.45%	19/04/2017	12/12/2017	A	0.016%
Goldman Sachs International Bank	20,000,000	0.71%	22/06/2017	19/12/2017	A	0.017%
Australia and New Zealand Banking Group Ltd	5,000,000	0.40%	03/07/2017	03/01/2018	AA-	0.008%
Lloyds Bank Plc	18,000,000	0.65%	03/05/2017	05/02/2018	A	0.024%
Lloyds Bank Plc	21,400,000	0.39%	12/07/2017	12/02/2018	A	0.025%
Nationwide Building Society	11,100,000	0.33%	10/08/2017	12/02/2018	A	0.025%
Lloyds Bank Plc	9,400,000	0.65%	17/05/2017	19/02/2018	A	0.027%
Goldman Sachs International Bank	10,000,000	0.75%	01/06/2017	01/03/2018	A	0.028%
Nationwide Building Society	25,000,000	0.40%	26/07/2017	12/03/2018	A	0.030%
Barclays Bank Plc	25,000,000	0.84%	10/04/2017	29/03/2018	A-	0.032%

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Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
Leeds Building Society	8,000,000	0.48%	29/06/2017	03/04/2018	A-	0.033%
Skipton Building Society	20,000,000	0.77%	24/04/2017	23/04/2018	BBB+	0.109%
Barclays Bank Plc	14,000,000	0.85%	26/04/2017	25/04/2018	A-	0.037%
Leeds Building Society	2,000,000	0.37%	16/08/2017	16/05/2018	A-	0.040%
Nationwide Building Society	13,800,000	0.37%	16/08/2017	16/05/2018	A	0.040%
Goldman Sachs International Bank	30,000,000	0.87%	19/05/2017	18/05/2018	A	0.040%
Goldman Sachs International Bank	20,000,000	1.02%	03/07/2017	02/07/2018	A	0.047%
Goldman Sachs International Bank	20,000,000	0.95%		Call365	A	0.056%
Total Investments	**£850,500,000**	**0.57%**				0.014%

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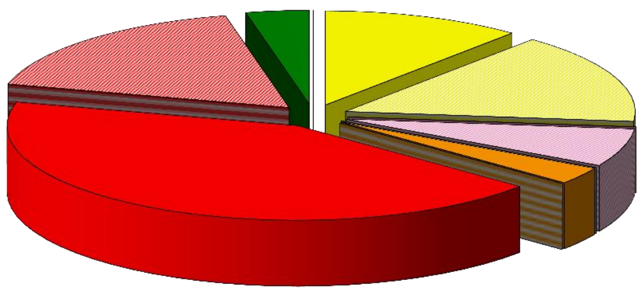
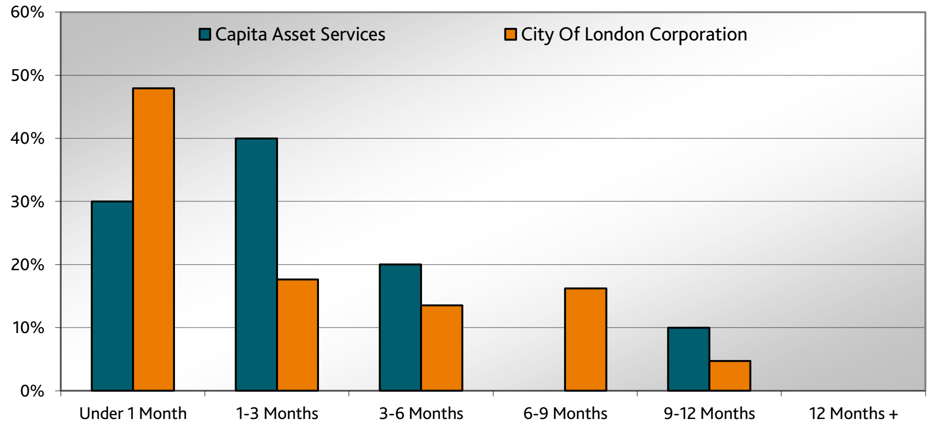
Portfolio Composition by Capita Asset Services' Suggested Lending Criteria



Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour



Portfolios weighted average risk number = 3.71

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/USDBFs WAM	Excluding Calls/MMFs/USDBFs WAM at Execution
Yellow	26.69%	£227,000,000	58.15%	£132,000,000	15.52%	0.32%	9	52	23	124
Pink1	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Pink2	6.47%	£55,000,000	100.00%	£55,000,000	6.47%	0.91%	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Orange	2.94%	£25,000,000	0.00%	£0	0.00%	0.39%	75	172	75	172
Red	60.38%	£513,500,000	28.90%	£148,400,000	17.45%	0.65%	116	208	141	271
Green	3.53%	£30,000,000	0.00%	£0	0.00%	0.67%	231	335	231	335
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
	100.00%	**£850,500,000**	**39.44%**	**£335,400,000**	**39.44%**	**0.57%**	**83**	**156**	**121**	**243**

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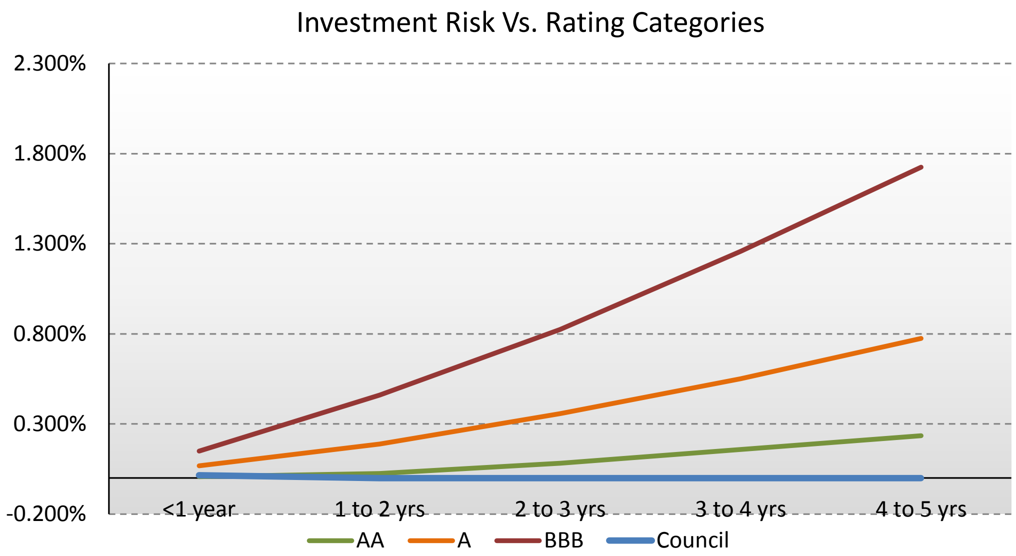
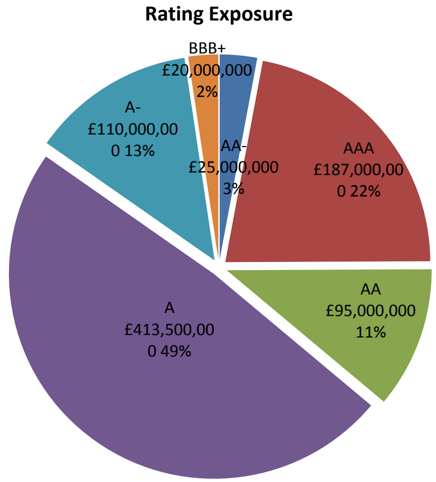
Investment Risk and Rating Exposure



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	0.015%	0.000%	0.000%	0.000%	0.000%



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.

Monthly Credit Rating Changes

FITCH

Date	Update Number	Institution	Country	Rating Action
29/08/2017	1546	Qatar Sovereign	Qatar	Downgraded to 'AA-' from 'AA', removed from Negative Watch and placed on Negative Outlook

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Monthly Credit Rating Changes

MOODY'S

Date	Update Number	Institution	Country	Rating Action
02/08/2017	1542	Abbey National Treasury Services Plc	UK	Long Term Rating was affirmed at 'Aa3'; Outlook changed to Stable from Negative. Short Term Rating affirmed at 'P-1'
02/08/2017	1542	Bank of Scotland Plc	UK	Long Term Rating was removed from Stable Outlook and placed on Positive Watch. Short Term Rating was affirmed at 'P-1'
02/08/2017	1542	Lloyds Bank Plc	UK	Long Term Rating was removed from Stable Outlook and placed on Positive Watch. Short Term Rating was affirmed at 'P-1'
02/08/2017	1542	Santander UK Plc	UK	Long Term Rating was affirmed at 'Aa3', Outlook changed to Stable from Negative. Short Term Rating affirmed at 'P-1'
17/08/2017	1545	Danske Bank	Denmark	Long Term Rating was upgraded to 'Aa3' from 'A1', Outlook changed to Stable from Positive. Short Term Rating affirmed at 'P-1'

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Monthly Credit Rating Changes

S&P

Date	Update Number	Institution	Country	Rating Action
29/08/2017	1547	Qatar Sovereign	Qatar	Affirmed at 'AA-', removed from Negative Watch and placed on Negative Outlook