CLWYD PENSION FUND
ECONOMIC AND MARKET UPDATE
PERIOD ENDING 31 DECEMBER 2020

ECONOMIC AND MARKET BACKGROUND

Quarter ending 31 December 2020

Following the strong economic rebound during the summer, the global economy started to slow again during the fourth quarter as restrictions gradually returned to all major regions. Nevertheless, the economic impact was not nearly as bad as in early 2020 as businesses were much better prepared this time. Good news regarding vaccine roll-out and positive developments on several political fronts led investors to look beyond these setbacks and expectations were set towards a major recovery in 2021. This drove a risk-on rally, leading to another quarter of strong returns for risk assets and weaker performance for defensive assets.

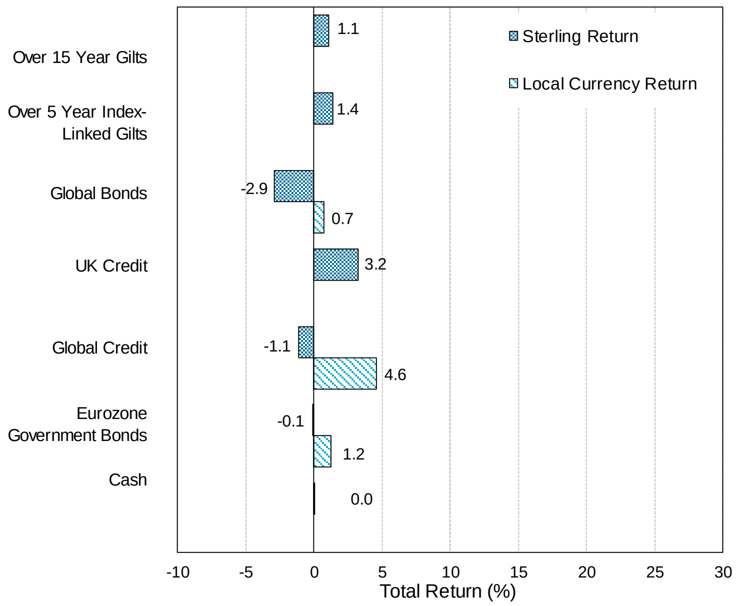
The US economy rebounded by 33.4% quarter-on-quarter (annualised) to the end of September 2020 which is the biggest expansion ever. Early estimates for the fourth quarter of 2020 indicate low single digit growth at best after restrictions returned to many US states. Monetary and fiscal policy remained very loose, with the Federal Reserve committing to keeping asset purchases at current levels for the coming months at least and a $900bn fiscal stimulus package was approved. Investors were relieved after the November election yielded what was perceived to be a centrist and fairly market friendly US government.

China is still the furthest ahead in terms of economic recovery after its GDP rebounded over the last two quarters with lost output in early 2020 already fully recovered. Emerging markets outside East Asia remain more severely affected by COVID-19 and except for India, case growth is still at peak levels even if a weaker US Dollar and a recovery in natural resources prices has helped the many commodity exporting countries in this region.

Quarter-on-quarter GDP also saw record rebounds over the third quarter for the Eurozone and Japan of 12.5% and 5.3% respectively (non-annualised). Whilst Japan is expected to see low growth over the fourth quarter, renewed lockdowns in Europe that started early in the quarter are expected to result in negative GDP growth in low single digits for the Eurozone for the fourth quarter.

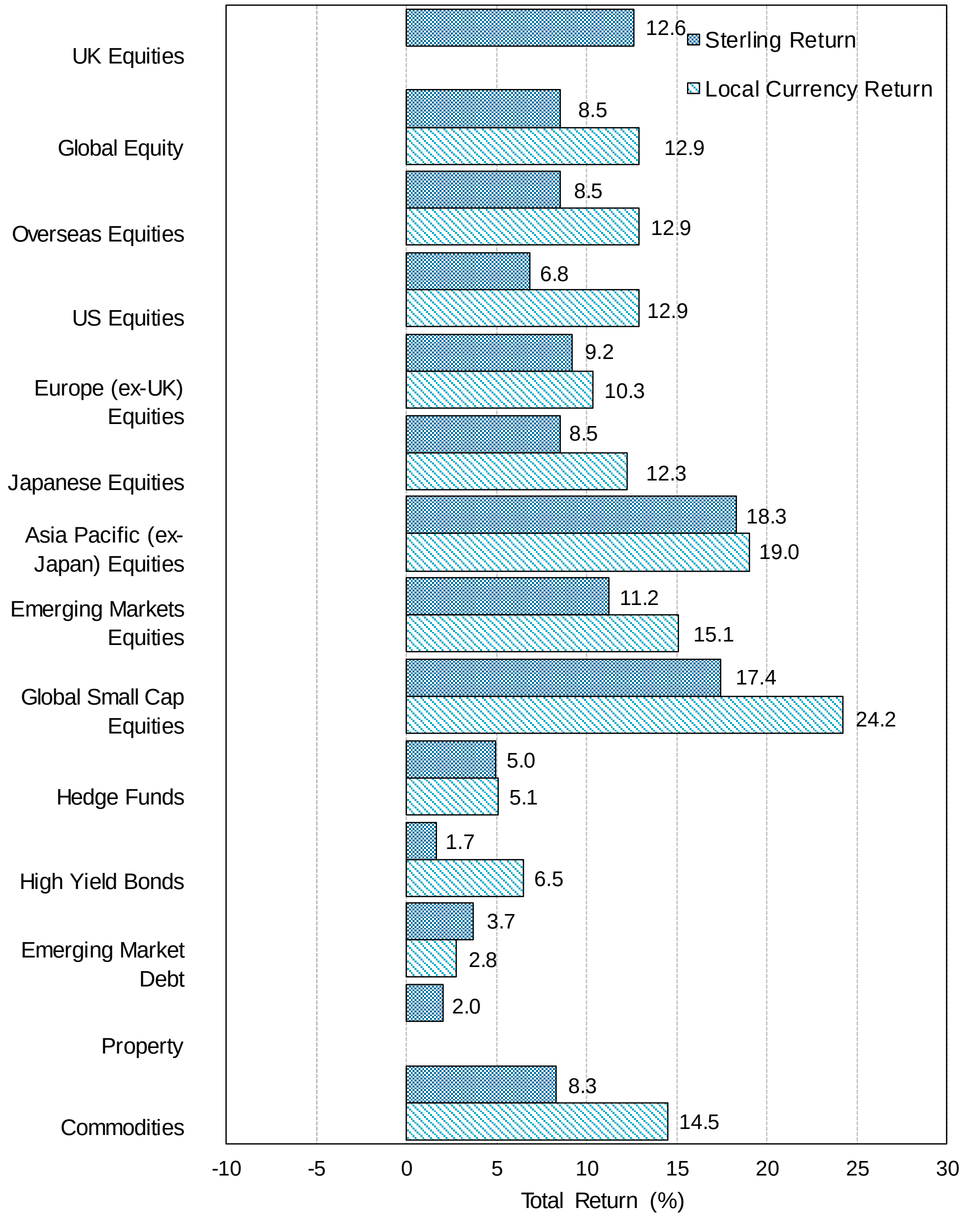
In the UK, quarter-on-quarter GDP rebounded by 16% to the end of June (non-annualised). Headline CPI inflation marginally fell to 0.3% at the end of November from 0.5% at the end of September. The Brexit deal at year end was major good news but this was tempered by large swathes of the country entering Christmas in full lockdown after a more contagious strain of COVID-19 started to spread across London and the South East.

Defensive Assets - Index Performance



Source: Thomson Reuters Datastream.

Growth Assets - Index Performance



Source: Thomson Reuters Datastream.

MARSH & McLENNAN COMPANIES

Equity Market Review

Global equity markets rallied over the quarter, returning 8.5% in sterling terms and 12.9% in local currency terms – the third positive quarter in a row. Many major indices, including the S&P500, showed mid to high double digit returns for the year. Volatility was higher over the third quarter as markets reacted to a return of pandemic-related restrictions and to major political events including the US election and the final Brexit negotiations.

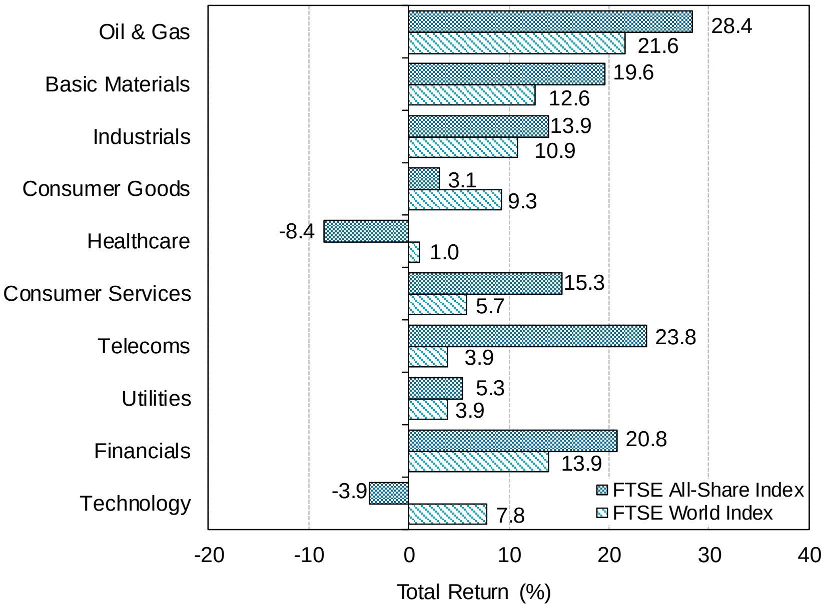
US equities returned 6.8% in sterling terms, compared to 12.9% in local currency terms over the quarter, as markets focused on the prospect for vaccine roll-outs. European (ex UK) equities returned 9.2% in sterling terms (10.3% local) driven by similar dynamics as well as a cyclical recovery in value stocks that are expected to benefit most from a full reopening and have a heavier weight in many European indices.

Emerging markets equities returned 11.2% in sterling terms, (15.1% local), driven by China's advanced recovery as well as a rebound in some other EM countries, especially commodity producers, that had been lagging for much of the year.

Global small cap stocks returned 17.4% in sterling terms (24.2% in local currency). Small caps outperformed global equities by a wide margin in local currency terms, as investors saw room for small caps to expand in a full reopening.

Percentage Performance by Industry Tier -

Three Months to 31 December 2020

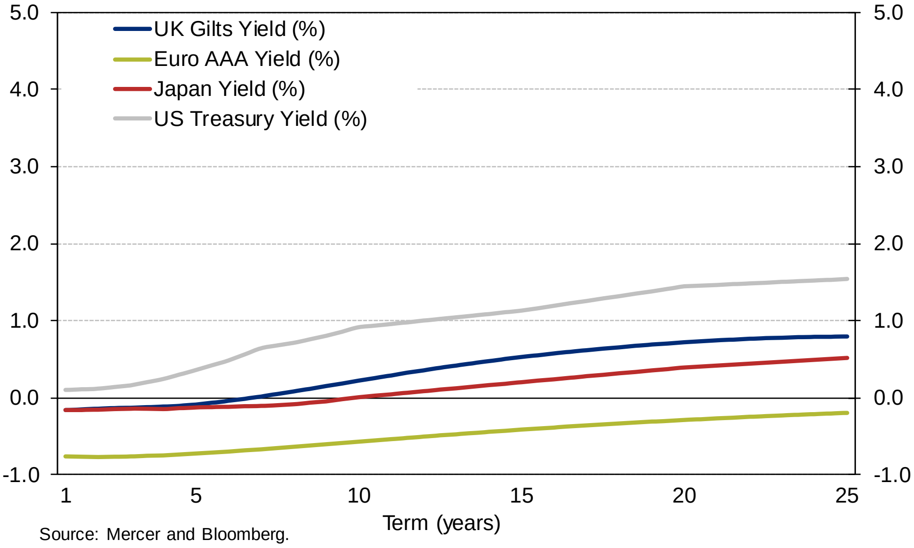


Source: Thomson Reuters DataStream.

The FTSE All Share rose by 12.6% over the quarter and was amongst the strongest developed market index performers. The large exposure to financials, oil & gas, and basic materials helped as these sectors were generally priced to benefit disproportionally from a reopening. The orderly resolution of Brexit also boosted sentiment, especially for smaller domestic stocks that outperformed UK large caps by wide margins.

Bond Market Review

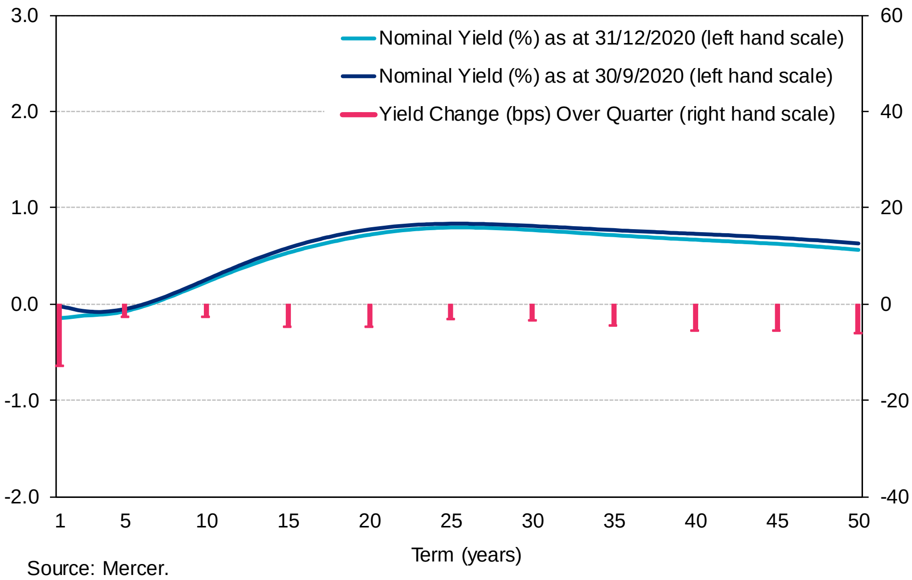
Government Bond Yield Curves



Source: Mercer and Bloomberg.

The 10 year government bond benchmark yield rose by over 20 basis points for the US over the quarter reflecting increased confidence in a recovery in US growth and higher medium-term inflation expectations as well as additional stimulus. For the UK, Eurozone and Japan, yields were either largely unchanged or slightly lower, reflecting more modest growth expectations in these three regions.

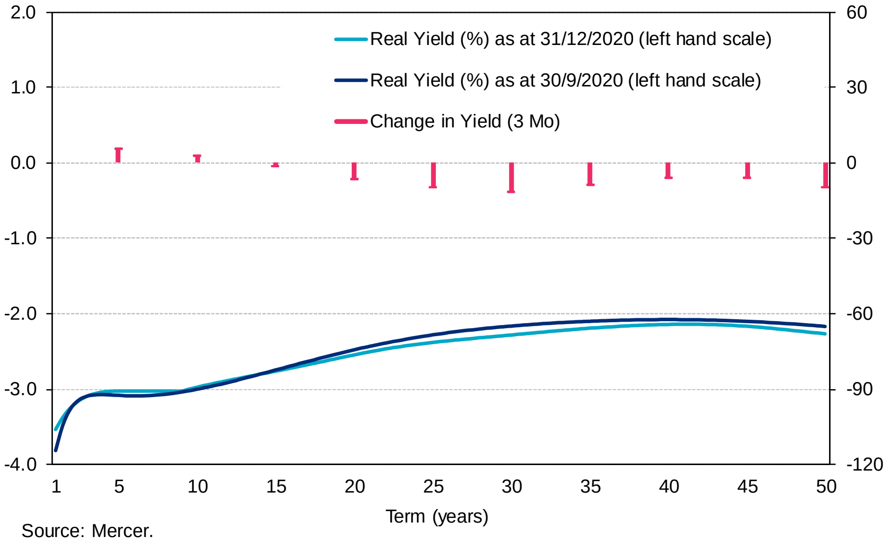
Changes in the UK Bond Yield Curve over the Quarter



Source: Mercer.

The UK yield curve shifted down marginally over the quarter as inflation expectations changed little and additional fiscal stimulus as well as monetary accommodation was announced in the UK over the quarter.

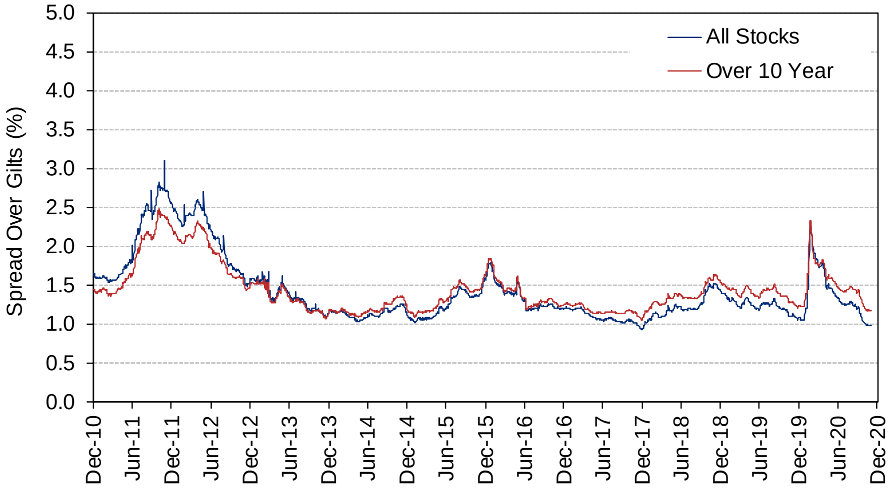
Changes in the UK Index-Linked Gilt Yield Curve over the Quarter



Source: Mercer.

UK real yields shifted down marginally over the quarter, in line with the small decrease in nominal yields. The UK Treasury announced the outcome of the RPI consultation confirming that RPI will increase in line with CPIH from 2030.

ICE BofAML Sterling Non-Gilts Indices Credit Spreads



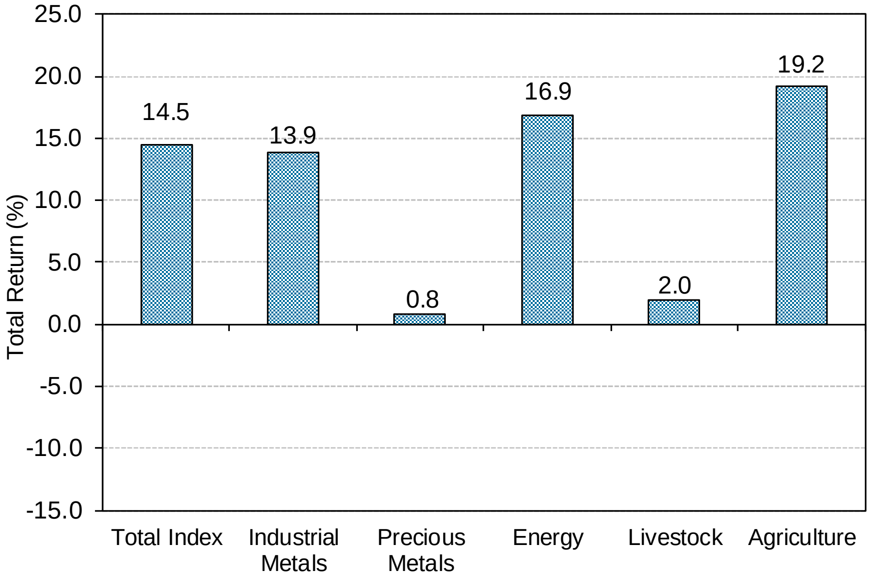
Source: Thomson Reuters Datastream.

UK investment grade credit spreads narrowed over the quarter as risk-on sentiment continued. Investment grade spreads have now retraced all of the widening experienced earlier in the year and ended the year below their late 2019 level.

Commodities

S&P GSCI Index in US Dollars - Commodities

Three Month Sector Performance to 31 December 2020

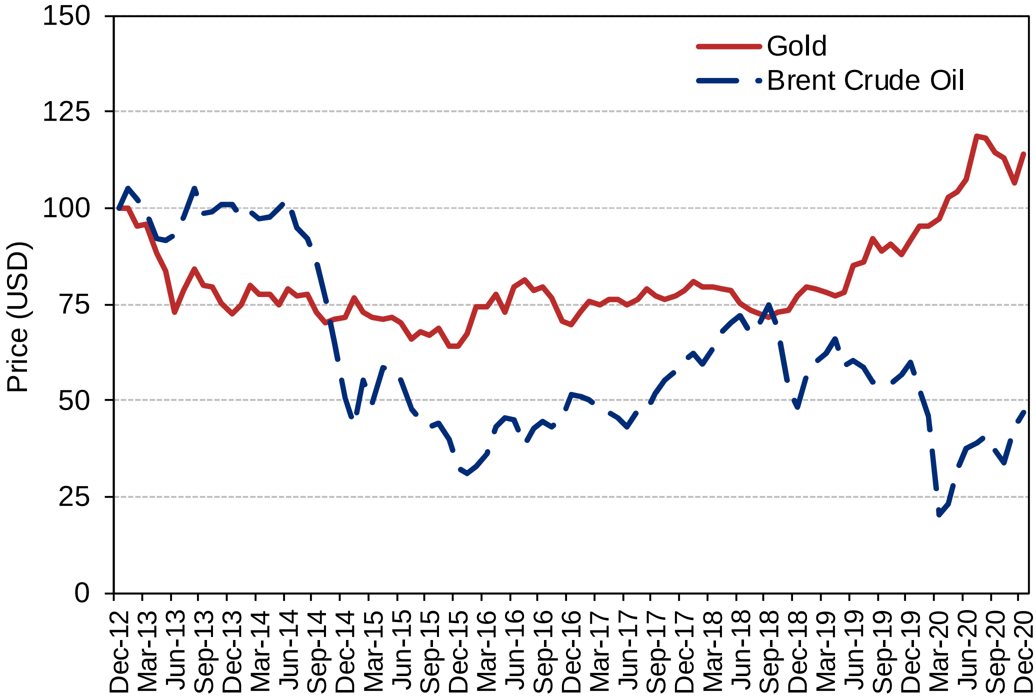


Source: Thomson Reuters Datastream.

Commodity markets continued their rebound over the quarter. Expectations of a strong economic recovery gaining pace in the coming year drove demand for cyclical commodities across the board as markets looked beyond the return of COVID-19 restrictions in many countries over the fourth quarter towards the prospect of a strong economic recovery once vaccination roll-outs begin, coupled with potentially less political uncertainty. Gold was flat over the quarter as markets were driven by risk-on sentiment that favoured cyclical commodities and energy.

Change in US Dollar Price to 31 December 2020

(Gold and Brent Crude Oil - Rebased to $100 on 31 December 2012)

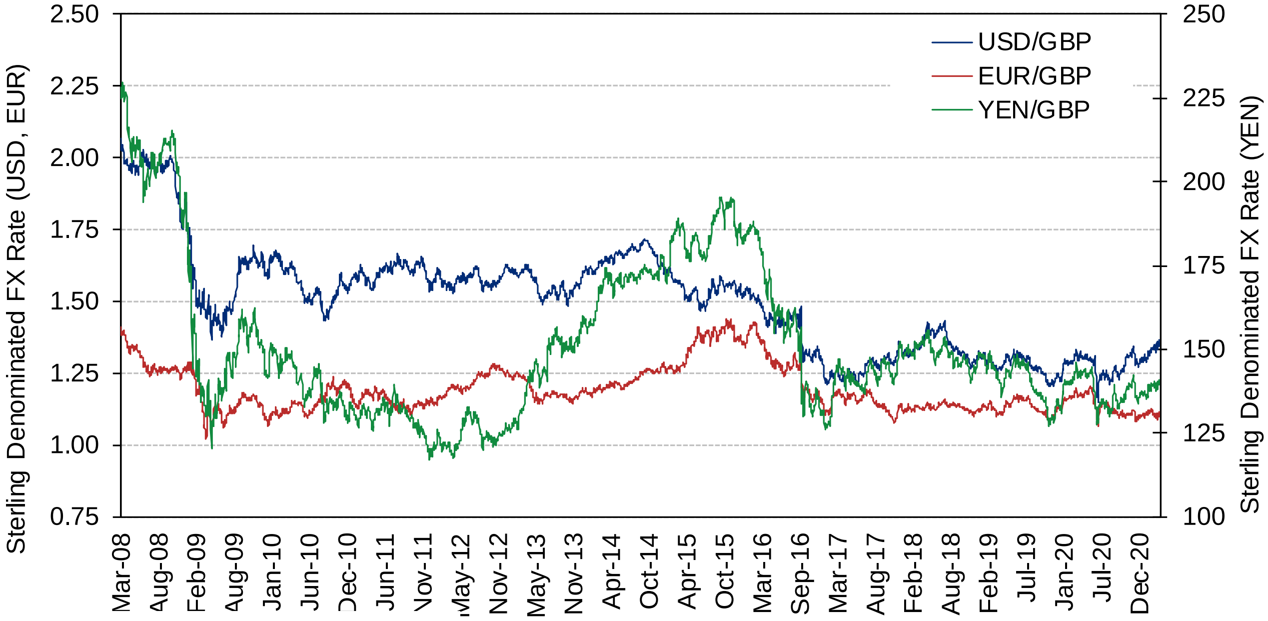


Source: Thomson Reuters Datastream.

Currency Market Review

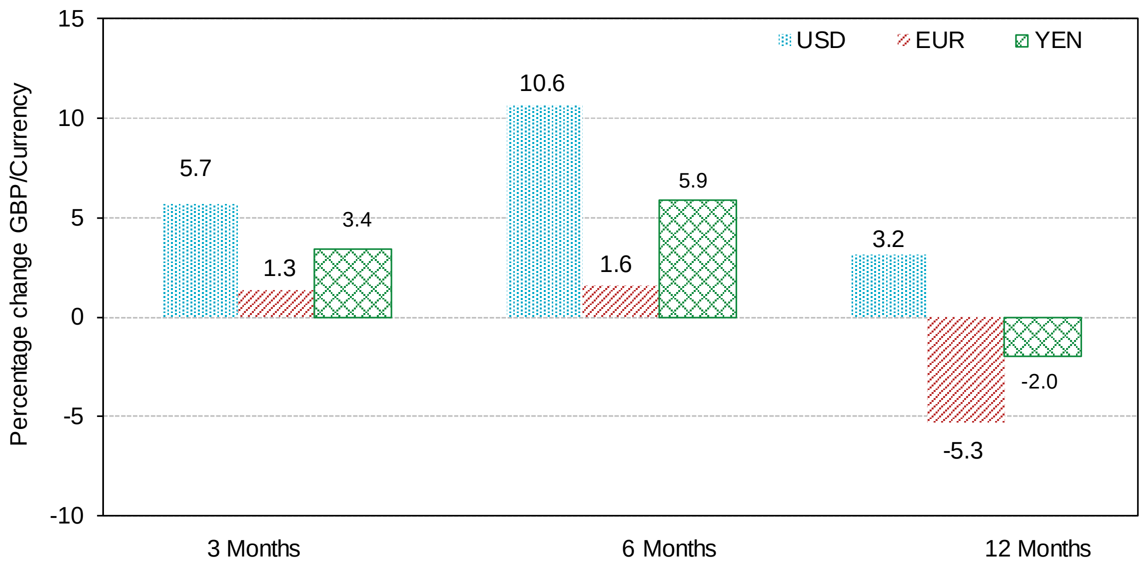
Sterling strengthened against all major developed currencies over the quarter but only rose against the US dollar for the year as a whole. The Brexit agreement in late December boosted sentiment for sterling at year end as the feared disruptions in trade did not generally materialise.

Sterling Denominated FX Rates



Source: Thomson Reuters Datastream.

Change in Sterling against Foreign Currencies



Source: Thomson Reuters Datastream.

Other Assets

UK property as measured by the MSCI Index increased by 2.0% over the quarter to 31 December 2020.

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