Appendix B

LGPS CENTRAL LIMITED TACTICAL ASSET ALLOCATION

ISSUE 14 • June 2021

LGPS Central Limited

FOR PROFESSIONAL CLIENTS ONLY

CIO SUMMARY

Introduction

Welcome to the fourteenth edition of our LGPS Central Limited ("LGPSC") Tactical Asset Allocation ("TAA") Report. We hope that you, your family and friends can truly enjoy the Summer.

Summary of Strategy Thoughts

Since the publication of the previous edition of this report, the vaccination rollout has advanced which has helped with the reopening of the economy. The speed of economic recovery will likely depend on the effectiveness of vaccination programs against any new variants. The economic data already reflects a recovery starting from the end of March due to the base effect, and we may explain this recovery as a distortion-led one. There is uncertainty in the projections of inflation expectations with the current high level of inflation expected to be transitory.

We continue to see the recovery as following the path of a radical sign (that is, the shape of a square root symbol), with a slight slope of recovery moving forward that will most likely depend on various factors: (a) continued fiscal and monetary support; (b) the level of unemployment; (c) consumer behaviour, which will determine to a large extent the survival of many SMEs; and (d) whether new variants of the virus will be resistant to the vaccine. Given that the recovery is so much dependent on the vaccination rollout, we see the global recovery happening at different speeds across the globe with the UK, US and the EU leading it and the rest of the developed world closely behind, followed by emerging markets (ex China).

Our view on tactical positioning maintains growth assets at **neutral** given their stretched valuations. We remain **underweight** on stabilising assets and **overweight** on income assets.

In terms of factors, the model is **overweight** on **size, momentum** and **value**. On currencies, we continue to remain positive on Sterling (and Yen). Sterling continues to be oversold and we believe that most of the bad news (domestic deficits, low level of rates and continued uncertainty as to the long-term effect of Brexit) are now discounted in the current level. The success of the UK vaccine programme and gradual 'unlocking' of the domestic economy should bode well for future growth and support Sterling's valuation. We continue to believe in the US Dollar's prolonged period of weakness, exacerbated by the twin domestic deficits made worse by further fiscal measures. We are neutral on the Euro as the positive impact from the advance of the rollout programme and the reopening of the EU economy is neutralized, in our view, by the fiscal package designed to help the EU recovery. This may be further exacerbated by the recent change to ECB inflation target to 'around' 2%, a level that they have failed to achieve during their existence. The Yen will continue to benefit from any periods of 'risk off' sentiment and we continue to expect its relative appreciation.

Gordon Ross (CIO)

LGPS CENTRAL LIMITED'S VIEW ON WEIGHTINGS

The following table gives a summary of our view on the 6-18 months tactical positioning horizon.

Table1: Weightings ▲ Upgraded, ▼ Downgraded compared to previous quarter

	Significant Underweight	Underweight	Neutral	Overweight	Significant Overweight
Estimated Probability	80-70%	70-65%	55-45%	70-65%	70-80%
BROAD ASSET CLASS		Stabilising	Growth	Income	
GROWTH ASSET CLASS		US Equities Asia Pac Equities ▼	GEM Equities ▼ Private Equity EU Equities ▼	Commodities Japan Equities UK Equities	
INCOME ASSETS		HY Credit ▼	Property	EM Debt ▼ Infrastructure ▼	
STABILISING ASSETS		JP Bonds Index-Linked US Bonds EU Bonds ▲	UK Bonds ▲ IG Bonds ▲	Gold ▲	
INVESTMENT STYLES		Growth Quality/ESG	Low Volatility	Value Size ▲ Momentum ▲	
CURRENCIES		US Dollar	Euro	GBP, Yen	

LGPSC's view on "Weightings":

- Income Assets are maintained at overweight, due to Infrastructure, EM Debt; we are downgrading HY Credit to underweight.
- Growth Assets kept at neutral. We would rather be overweight on growth assets, but the high valuations prevent us from adopting that view.
- Stabilising Assets maintained at underweight.

BROAD ASSET CLASSES

Table 2: Growth/Income/Stabilising Assets

	Model Score[1]	View	Investment Notes
GROWTH	0	Neutral	No change from last time.
INCOME	1 ▼	Overweight	Small decrease of the overweight exposure from last time.
STABILISING	-2	Underweight	No change from last time.

Table 3: Historical Annualised Returns in local currency (* except for the 3 months, where total return is used)

	3 months*	One year	Three years	Five years	Ten years	Twenty years	Bloomberg Ticker
GLOBAL EQUITIES	7.39	39.84	15.08	15.17	10.48	7.42	FTAW01 Index
PRIVATE EQUITY	12.62	41.40	16.57	17.47	13.41	#N/A N/A	IPRV LN Index
PROPERTY	11.97	32.90	12.05	8.14	10.30	10.49	REIT INDEX
INFRASTRUCTURE	2.26	23.09	5.52	6.17	6.19	#N/A N/A	SPGTIND Index
HIGH YIELD	1.75	12.95	6.33	7.01	8.37	10.37	HL00 Index
UK GILTS	1.78	-6.47	3.29	2.16	4.96	5.32	G0L0 Index
UK INDEX-LINKED	3.58	-3.96	4.97	4.68	7.29	7.03	G0LI Index
GOLD	3.28	-10.90	10.49	5.20	3.19	9.97	XAUGBP Curncy

Source: Bloomberg (NB: assumes dividends were reinvested), note: Listed proxies have been used for Infrastructure, Property and Private Equity.

Table 4: Correlation Matrix (5 year historical correlation)

	FTSE All World AW TR GBP	iShares Listed Private	DJ REIT	S&P Global Infra	Sterling High-Yield	UK Gilt	UK Inf-Link Gilt	XAUGBP Index
GLOBAL EQUITIES	1.000	0.810	0.755	0.867	0.700	-0.106	0.089	-0.083
PRIVATE EQUITY		1.000	0.718	0.799	0.652	-0.023	0.177	0.083
PROPERTY			1.000	0.835	0.630	0.130	0.285	0.012
INFRASTRUCTURE				1.000	0.738	0.067	0.229	0.009
HIGH YIELD					1.000	0.041	0.195	-0.101
UK GILTS						1.000	0.791	0.479
UK INDEX-LINKED							1.000	0.419
GOLD								1.000

Source: Bloomberg Note: listed proxies have been used for Infrastructure, Property and Private Equity

LGPSC's view on Broad Asset Classes:

- We can see from Table 3 above, that during the last Quarter, the Growth asset class enjoyed strong performance, close to its ten year averages. Conversely, the Stabilising asset class returns were well below the long-term averages. The Income asset class generally performed above its long-term averages only in the Property segment, while Infrastructure and High Yield were way below their long term averages.
- From Table 4, we can see that the best asset class to protect both equity and high yield exposure is not UK sovereign bonds (gilts) but rather gold, which has a higher negative correlation on average with these two.
- While our recommendation is to be underweight Stabilising Asset classes, this recommendation still allows room for a selective approach in which one can still find niche opportunities.

[1] Refers to LGPSC model as described on page 7

Table 5: Growth Assets

	Model Score[1]	View	Investment Notes
UK Equities	2 ▲	Overweight	Increased the overweight position due to better currency and valuation scores
NORTH AMERICA Equities	-7 ▼	Underweight	Increased the underweight position due to worse currency score
EUROPE Equities	0 ▼	Neutral	Moved to neutral due to lower currency and sentiment scores
JAPAN Equities	3	Overweight	No change from last time
ASIA PAC Equities	-1 ▼	Underweight	Downgraded to underweight due to lower currency and deteriorating market risk score.
GEMs Equities	0 ▼	Neutral	Downgraded to Neutral due to deteriorating market risk score.
PRIVATE EQUITY	0	Neutral	No change from last time
COMMODITIES	1 ▼	Overweight	Reduced the overweight due to lower currency score

LGPSC's view on Growth Assets:

- Growth Assets continue to have expensive valuations.
- We are either overweight or neutral on most of the regional Growth Assets, except for North America and Asia Pacific.
- Markets have recovered helped by the monetary stimulus, and given that the stimulus will continue in Q3 21 while the fiscal stimulus will be slowly withdrawn, and the pandemic risk is expected to diminish over time, we can expect the valuations of the asset class to remain high with some volatility.

INCOME ASSET VIEW

Table 6: Income Assets

	Model Score[1]	View	Investment Notes
HY CREDIT	-1 ▼	Underweight	Moved to underweight from overweight due to much lower sentiment score
EMERGING MARKET DEBT	2	Overweight	No change from last time
PROPERTY	0	Neutral	No change from last time
INFRASTRUCTURE	1 ▼	Overweight	Reduced the overweight due to lower sentiment score.

LGPSC's view on Income Assets:

- We prefer Infrastructure and Emerging Market Debt.

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STABILISING ASSET VIEW

Table 7: Stabilising Assets

	Model Score[1]	View	Investment Notes
UK BONDS	0 ▲	Neutral	Upgraded to neutral due to better currency and market risk scores.
INDEX-LINKED	-3 ▼	Underweight	Increased the underweight due to lower currency score.
US BONDS	-2 ▼	Underweight	Decreased the underweight due to improved market risk scores.
JP BONDS	-4 ▼	Underweight	Increased the underweight due to lower sentiment and market risk scores.
EU BONDS	-3 ▲	Underweight	Increased the underweight due to lower currency score.
IG CORPORATE BONDS	0	Neutral	No change from last time.
GOLD	0 ▲	Neutral	Upgraded to neutral due to better currency and market risk scores.

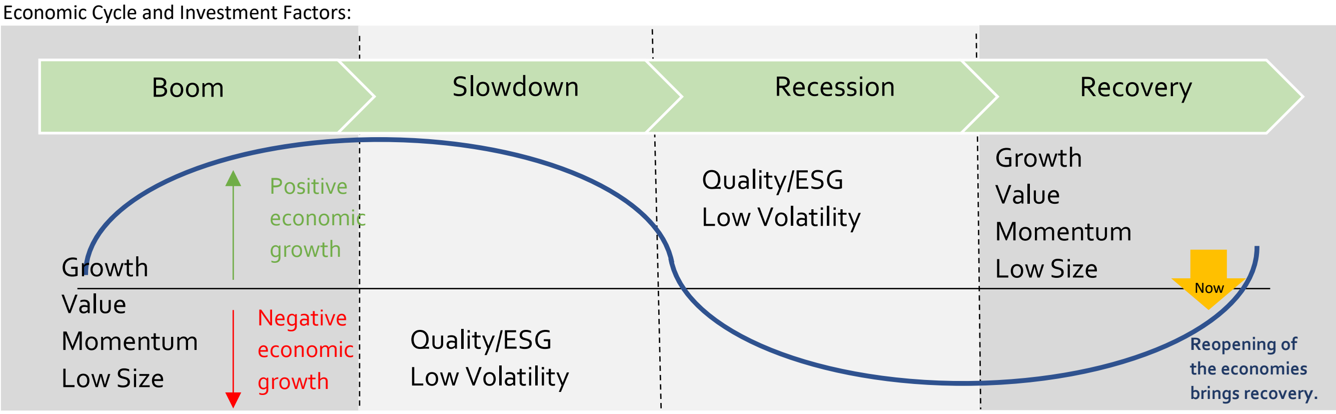
LGPSC's view on Stabilising Assets:

- Regionally, on government bonds, we are underweight across all regions except the UK.
- We are neutral on IG corporate bonds, gold and UK gilts.
- Gold offers good diversification and a hedge against currency debasement

INVESTMENT FACTORS (EQUITIES)

Factor Based investing provides a way of potentially adding outperformance relative to a market-cap-based approach at a much lower cost than active investing. It recognises that the market-cap-based index does not provide the best risk-adjusted return for a portfolio given its natural overweight to momentum, large cap and expensive stocks. In the following factor model, we have taken the seven factors of value, growth, income growth, size (small cap), ESG, low volatility and momentum and then applied the same criteria we use to consider other asset classes in our model assessing each factor for valuation, sentiment, economic suitability, risk suitability, investment cost and currency. Investment cost in factor-based investing is low relative to the other asset classes, though the momentum factor (given their higher turnover) and ESG factors (given their higher index costs) are both scored neutral. Given all strategies are global, the currency scores are all neutral. Note that ESG and quality share similar characteristics. Climate change as a factor is little correlated to specific economic cycles given its long-term investment impact horizon of 10-20 years. The graph below summarises the preferred overweight factor(s) depending on the various stages of the economic cycle.

Economic Cycle and Investment Factors:



FACTOR ASSET VIEW

Table 8: Investment Factors

	Model Score[1]	View	Investment Notes ▼
Value	1 ▼	Overweight	Reduced the overweight due to lower sentiment score.
Growth	-1	Underweight	Reduced the underweight as the economics score deteriorated.
Size	2 ▲	Overweight	Moved to overweight due to improved economics and market risk scores.
Momentum	2 ▲	Overweight	Moved to overweight due to an improved market risk score.
Low Volatility	0	Neutral	No change from last time.
Quality/ESG	-2	Underweight	No change from last time.

LGPSC's view on Investment Factors:

- Our preferred factors for this quarter are Value, Size and Momentum.

ABOUT LGPS CENTRAL LIMITED'S SCORING MODEL

LGPSC's model scores each asset class against its valuation, sentiment, economic outlook, market risk, currency and investment cost (scored between -2 and +2). Positive scores suggest strong overweight positions and negative scores, strong underweight positions. Where a zero is assigned, our view is neutral. The scores for the different assessment areas, e.g. valuation, sentiment etc. are then added to derive the final score for that asset class. Please note that sentiment is measured as to whether an asset class is over owned or over loved. We prefer to own asset classes that are under owned and under loved. We are constantly developing this scoring to include other variables such as ESG measures and technical factors.

This quarter we have changed the model to exclude investment cost as a factor. We believe with the abundant liquidity at present, and the fact that the investment cost is reflected in the price, asset class scores do not need to reflect on the investment cost.

Q2 LGPS CENTRAL LIMITED MARKET UPDATE[2]

The second quarter of 2021 has been eventful, with volatility returning to global markets throughout the quarter. That said, the macroeconomic picture has continued to improve, as a number of major economies have seen improving economic indicators as economies continue to open up.

Throughout the quarter, equity markets have broadly performed well with the majority of major indices finishing the quarter positively as many major economies have seen improving economic conditions. The MSCI World Index returned 7.31% and the S&P500 continued its strong performance, returning 8.17% on the quarter. The U.S. economy continued its recovery in the second quarter, aided by the increased pace of Covid-19 vaccinations, further government stimulus and an increase in economic reopening.

The MSCI Asia ex Japan Index performed strongly, returning 3.42% in the second quarter amid continued investor optimism for a return to normality. However, Asian markets were down towards the end of the quarter following a resurgence in Covid-19 infections, a stronger US dollar and further lockdowns due to the delta variant. Eurozone shares gained in the quarter, supported by a strong corporate earnings season and an acceleration in the pace of the vaccine roll-out. Markets reacted positively with both the Euro Stoxx 50 and the FTSE 100 returning 3.70% and 4.82% respectively.

Economic data over the last three months has generally been very strong, especially in the US, which posted a growth rate of 6.4% YoY in the first quarter. The Eurozone economy expanded 0.2% according to Eurostat in the second quarter and many leading economic indicators such as the purchasing managers' index (PMI) have reached multiyear heights in many regions. The UK economy contracted by 1.6% QoQ in Q1 2021. The Q1 decline should be followed by a robust rebound in Q2 as economic conditions improve and the release of pent-up demand continued.

The reopening of economies and the quick rebound in activity that has followed has fuelled inflation in some countries. In May, the US core consumer price index (CPI) rose from 3% YoY in April to 3.8% YoY in May, although some underlying details suggest that this may be due to temporary factors such as the rise in used car prices. The UK saw similar price pressures through the quarter with CPI inflation at 2.1% in May 2021, up from 1.5% in April which means that inflation is now above the Bank of England's 2% target for the first time since July 2019. The associated market reaction has been muted as the magnitude of the increases has been seriously affected by the statistical 'base' effects of low numbers recorded last year 'falling out' of the year on year reports

Bond yields across major markets fell in the second quarter of 2021, with the US and UK 10 year yields falling by 2.7 and 12.9 basis points respectively. While debate on whether inflation will be transitory continues in the market, central banks including the US Federal Reserve Board (FED), continue to reaffirm their opinion that inflation is transitory. The Federal Reserve's messaging, in combination with a short covering rally in the long end caused the flattening of the yield curve. The FED's rate-setting meeting brought no change to policy projections but indicated that interest rate rises could come in 2023.

Commodity markets continued their robust performance as a result of the continued global recovery. Oil prices finished the quarter up 18.24% at over $75 a barrel, and other industrial commodities such as iron, lead and nickel also advanced during the quarter driven by similar factors.

[2] Performance for the quarter measured over period of 31/03/2021 to 30/06/2021

Q2 2021 LGPS CENTRAL LIMITED RESPONSIBLE INVESTING UDPATE

In early June, the Group of Seven (G7) advanced economies met for their 47th Annual Summit. The members endorsed a range of initiatives focusing on the Covid-19 recovery, the global economy and climate change. With the impending COP26, 2021 is set to be an important year for climate change, and world leaders at the summit reaffirmed their commitment to achieving net-zero Global Greenhouse Gasses (GHG) emissions by 2050. Within the climate change theme, pledges were made to cease direct new government funding for unabated coal-fired power generation i.e. without the use of carbon capture and storage. As the deployment of coal power is more prominent in developing countries, the G7 participants committed to provide these nations with $2.8 billion in funding to shift to cleaner energy. In 2009, developed countries agreed on a climate finance target of $100 billion/year to help developing countries transition to a low carbon economy. This target has not been met, partly due to the Covid-19 pandemic. Despite promises from G7 summit leaders to ramp up contributions to meet the $100 billion/year pledge, concerns remain over the adequacy and level of commitment from developed nations. All eyes will now be on COP26 and whether a global climate change agreement can be agreed upon by all nations.

With the 2021 AGM season coming to a close, it is clear that there is increasing pressure on companies, in all sectors, to address climate change and other ESG factors within their business models. This year's AGM season received record levels of support from investors for ESG-related shareholder proposals. Whilst shareholder proposals for ESG topics permeated all sectors, climate change resolutions in the Energy sector have featured most prominently in the headlines. Perhaps most notable was the shareholder revolt at U.S. oil giant ExxonMobil. An activist hedge fund, Engine No.1, successfully replaced three of ExxonMobil's Board members, following concerns the Company was failing to implement a viable climate change strategy. The independent board members received unlikely support from some of ExxonMobil's largest shareholders – BlackRock, Vanguard and State Street – a significant signal to other companies in the Oil & Gas sector. ExxonMobil's closest rival, Chevron, was not immune to shareholder discontent. The U.S. Oil & Gas company was subject to a 'Follow This' shareholder resolution requiring the reduction of Scope 3 emissions. The resolution passed with 61% of shareholder support. With average investor support for ESG shareholder resolutions increasing from 12% to 44% between 2020 and 2021 alone, there is clear momentum building for ESG topics, which is likely to continue to grow.

Closer to home, Oil & Gas company Royal Dutch Shell was ordered by a Dutch court to reduce its emissions by 45% by 2030. The landmark case, spearheaded by Friends of the Earth and over 17,000 Dutch citizens, is the first time a company has been court ordered to legally align its policies to the Paris Agreement. Hailed as a precedent setting event, it is unlikely to be the last time we will see high emitting companies face legal action for their carbon emissions.

In May, the International Energy Agency (IEA) published its long-awaited pathway to net-zero report. The 1.5°C scenario sets out a roadmap for achieving net-zero emissions by 2050 without the use of offsets from land use or forestry and with low reliance on negative emissions technologies. A number of the assumptions in their net-zero plan were significantly more severe than most users of the report had anticipated. Effective immediately, all new investments in fossil fuel supply projects are incompatible with a 1.5°C pathway. To fill the energy demand gap, investments in renewable and low carbon technologies would need to increase to approximately $5 trillion per year by 2030, up from a current $2 trillion per year. We expect to see some real momentum for decarbonisation in line with the Paris Agreement following this report. Findings and scenarios by the IEA are used in effect as a benchmark for planning by industries, and in many cases are considered definitive by governments and feed into the basis of national energy policy. The IEA report will also directly affect our discussions at LGPS Central on climate ambitions and our expectations on companies.

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RISK ANALYSIS

Table 9: Risk in order of probability

RISK	LGPSCL Possibility	LGPSCL Impact	Change on quarter	Comment	LGPSC favoured assets to protect against the risk
CORONAVIRUS	Medium	Medium	→	While some countries are more advanced in the vaccination process, others are lagging behind and experiencing a third wave. Still, we feel comfortable in reducing the risk given the discovery and availability of new vaccines	Clients without equity protection should consider establishing protection. Selective investments and a diversified portfolio.
EQUITY DOWNTURN	High	Medium	↑	The probability of equity downturn has increased as we see potential risk of tapering, high valuations, leverage.	Renewing equity protection should be considered.
NATURE OF RECOVERY	Medium	Medium	→	The recovery in different parts of the world depends on the progress of the vaccination. In some countries with more advanced vaccination programs it may look more like a V-shaped recovery, while globally it may resemble a radical sign (V with a "tail"). Possibility of zombie companies slowing down the economy with bankruptcies having slowed down, with zombie companies relying on support to stay alive.	In the recovery phase, factors such as Size and Value are expected to perform best.
POLITICAL RISKS	Medium	Medium	→	Vaccination shortages have increased political risks within continental Europe. Some European countries will go through elections later in the year.	Overweight real assets.
ISOLATION & PROTECTION	Medium	Medium	→	Biden's relationship with China represents more of a continuity rather than a big change. One point will be what relationships China builds with the rest of the world post-Covid-19. The global leadership in technology may well be the focus.	Current tactical asset allocation will be dominated by the Coronavirus.

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RISK	LGPSCL Possibility	LGPSCL Impact	Change on quarter	Comment	LGPSC favoured assets to protect against the risk
CREDIT RISK/DEBT ISSUES	High	High	➡	EMD continues to offer opportunities, but concern remains over hard currency borrowings requiring repayment with some regime changes challenging previously agreed restructurings. Credit markets remain well supported by CB liquidity and QE purchases. Search for higher yields has led spreads lower across the credit spectrum despite record levels of issuance.	Selective Credit and IG Corporate Bonds.
CURRENCY RISK/ STERLING STRENGTH/US$ WEAKNESS	Low	Moderate	➡	The currency preference will be (in declining order) GBP, YEN, EUR, USD; in particular, GBP strength and USD weakness is expected. Gold we view as positive.	Buy GEM equities, commodities which historically benefit from a weaker dollar.
CLIMATE-RELATED TRANSITION RISK	Medium	Medium	➡	The EU Carbon Price remained above €45/tonne during Q2 hitting a new high at €56.7/tonne. The post-Brexit UK Emissions Trading Scheme opened in May, with the carbon price topping £50 /tonne. The Net Zero Asset Manager Initiative has grown to represent nearly half of the world's AUM.	Underweight Energy & GEMs, overweight Renewables and Sustainable Investment themes such as Infrastructure.
CLIMATE-RELATED PHYSICAL RISK	Medium	Moderate	➡	Unprecedented heatwaves across the U.S. and Canada attributed to climate change. Amazon deforestation rises for the fourth consecutive month, totalling a 17% rise in the first 6 months of 2021.	Hold a well-diversified portfolio.
LIQUIDITY RISK	Low	Low	➡	Liquidity risk is not considered to be a main problem given the ample liquidity support from the central banks.	
INFLATION RISK	High	Medium	⬆	Short term inflation is expected to increase due to base effect, but we do not believe it has long-term sustainable support to continue rising.	

LGPSC's view on "Scenario Risks":

- The deployment of the vaccines is a game changer, though it is still a bit too early to declare victory. The short history and effectiveness of the vaccines, possible side effects and new variants of the virus remain open questions. Still, having a working vaccine and the success of the vaccine's rollout are the keys to reopening the economies.
- We highlight that holding a diversified portfolio still offers the best protection against those risks. Equity protection may be necessary. Specific risks such as a weakening US$ can be mitigated by hedging the currency risk. Reducing home-bias investments could prove to be beneficial post-Brexit.

Is the Independence of Central Banks in danger?

Gordon Ross, CIO

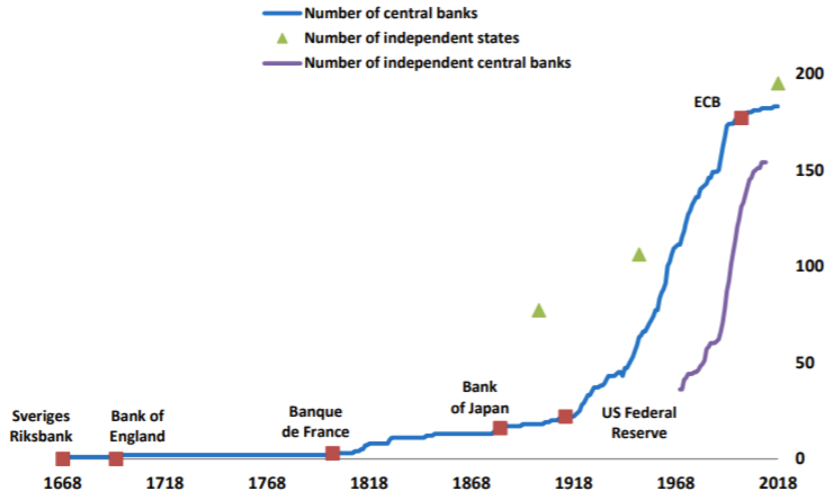
“The only problem we have is Jay Powell and the Fed,” a comment by then President Trump in August 2019, adding that “so far he has called it wrong and only let us down”. Could this be the beginning of the end of the independent central bank era, an independence that had been keenly fought for over the years in a pursuit to attain a lower average inflation rate and potentially aimed at reducing politically induced volatility of monetary policy and inflation. However, the current crisis has seen central bank balance sheets balloon to levels not hitherto imagined and has also seen central banks begin to be involved in, or pressured to steer, the supply of credit to tackle climate change, inequality and other pressing social problems, not forgetting those central bankers actually being fired for not agreeing with their political masters!

In order to see if the current situation really does change the future of central bank independence, it is useful to determine the route of travel of the current central bank blueprint.

Central bank independence is typically created as an independence from political or governmental influence. Many central banks are created from governmental legislation which spells out the limits, roles and targets of the central bank so there is always a relationship between the two and they cannot really be entirely distinct. Central banks have typically been responsible for various functions: issuing money, lender of last resort to commercial banks (and coincidentally, to the government), ensuring the stability of the banking system and setting monetary policy. It is perhaps the last two that have taken the focus of markets and commentators in recent years. Many governments give the central bank a target for inflation and may well consider other macro-economic objectives such as economic growth and unemployment. The necessity of having independence from political influence derives from the all too often temptations that politicians may well forgo their medium term economic responsibilities to encourage short term favourable economic climate (lower taxes, lower rates) to aid their possible re-election chances, only for the inevitable inflation consequence to occur after the election and need for remedial higher rates (possibly leading to higher unemployment) to reverse the trend. This boom/bust trend to the economic cycle led to the need for an independent authority that was at arm’s length from the influence of politicians and able to earn its own credibility.

Whilst central banks have existed for centuries, they only really achieved a degree of independence in the twentieth century. Sweden’s Riksbank dates back to 1668, the Bank of England to 1694 followed by the French and Japanese central banks in the nineteenth century. In all cases they had little well-defined role in setting monetary or financial stability policies and operated as an operational arm of government. By the end of the twentieth century, their number had grown to over 200 with as many as 80% having independence for the setting of policy (Chart 1). The Maastricht treaty stipulated that all countries wishing to enter the EU must have an independent national central bank so as to compliment the ECB and the European System of Central Banks whose role it is to ensure the Euro area benefits from price stability – this stance was founded on the premise that the success of the German economy in maintaining low inflation had arisen from the independence of the Bundesbank. It is also a slightly quirky requirement given that by applying to join the EU, each member state is already willing to concede its control over monetary policy in the long term to the ECB!

Chart 1: Number of central banks



Source: Central Banking Directory

So, what is central bank independence? Nowhere is it absolute with most subject to multiple ex-ante constraints and ex-post accountabilities as would be consistent with 'devolved' political entities [(1)]. The mix of these controls means there is a spectrum of 'independence' with the clearest division being those divided up between: (1) quasi-constitutional independence; (2) institutional independence; (3) personal independence and (4) financial and economic independence[(1)].

The ECB as described above is an example of the first category, with a Treaty providing that the ECB 'shall be independent in the exercise of its powers' and no individual EU member state can unilaterally amend nor repeal independence. In contrast, the Bank of England has no such constitutional protection and its independence could be repealed by ordinary legislation! (However, as a former Chancellor Nigel Lawson stated, "the mere announcement of the intention to do so would in itself be so damaging to market confidence that any government would be extremely reluctant to do attempt it").[(2)]

Institutional independence derives from legal remits and safeguards allowing central banks to carry out their tasks without interference from the executive branch of government. There are a range of institutional model of independence with one important differentiator being between target and instrument independence [(3)]. The UK Bank of England (BoE) is an example of target-dependence, being set certain statutory-set objectives including an inflation target to achieve and has certain statutory accountability requirements placed on it. The BoE has operational independence over its tools to achieve its objectives and thus can be classed as instrument independent.

Regarding personal independence, this refers to the way in which members are appointed and the reporting lines afforded them together with remuneration and security of tenure. A recent example of this causing contention and independence not quite living up to its claims was in the case of the Central Bank of Turkey, where President Erdogan has fired two governors and a deputy governor for not agreeing with his beliefs that interest rates should be lower. The effect this had on the Turkish Lira was pronounced as markets quickly lost trust in the independence of the central bank.

The final reference is to financial and economic independence – even if a central bank is free of the above interference, its independence could still be compromised if it had insufficient resources to achieve its mandate or could be pressured to engage in monetary financing of the government. This could include the central bank's ability to freely adjust its policy tools in pursuit of the goals of monetary policy.

Here the BoE is able to choose what part of its armoury to use to achieve its goals , that has included the practice of Quantitative Easing (QE) seen actively since the Global Financial Crisis in 2008 and more recently in response to the 2020 Covid-19 pandemic. With all these differentiators, the degree of central bank independence varies across the developed and developing world.

One of the recent criticisms, alluded to in the initial quote to this paper, is the accountability of independent central banks and have they become too 'maverick' and either crossed boundaries that are beyond their remit, or possibly worse, being pressured to cross such boundaries by their 'creators', thus blurring the concept of independence? With accountability comes transparency of information that will lead to trust and acceptability. The German Bundesbank (BUBA) operates with a high level of independence but almost no accountability yet seems sustainable by virtue of its reputation. The nation 'trusts' the BUBA to deliver low inflation because of its excellent record in doing so for more than 50 years. Whilst there is some evidence that low inflation is related positively to low accountability, this is not always the case and certainly the BoE is held accountable in several ways: the inflation target itself; publishing of the minutes of monthly meetings between the Chancellor and Governor and the Inflation Report.

Another concern is that central bank officials are not elected and whether there is insufficient oversight; how can a democratic society just hand over complete control of monetary policy to a group of unelected officials often appointed by the government of the time (and possibly inherited from a previous administration). This fact is about to hit the headlines in the US. President Joe Biden has one Federal Reserve Board (FED) governor to appoint. In addition, the term of the current Chairman (Jerome Powell) is up in early 2022 and potentially Biden could replace three other top FED members in the next year, and his recent reaffirmation of the FED's independence would still be true, just that its make up could be ''directed". So, does this mean the Administration will try to reshape the policy towards the Administration's agenda? Does that threaten the FED's real or even perceived independence? Could that lead to a market reaction or general decline in trust of the FED? The market consequences of this could be dramatic, especially at a time when all are on 'watch' to determine when some of the FED (and other central bank) polices invoked to ensure market stability and liquidity provisions to counter the economic and social effects of the Pandemic might be reversed.

Central bankers the world over have brought interest rates to or close to all-time lows, with some going negative. The economic recovery from the pandemic needed the additional help of fiscal policy for further stimulus but this sits outside the central bank's remit. In the current situation most administrations have acted as required and relaxed fiscal policy but this has not always been the case and a further criticism of the existence of independent central banks has been that they have had monetary policy pulling against fiscal policies. Their ability to create money and provide liquidity through QE has seen their 'balance sheets' swell to unprecedented levels and has given rise to accusations that this has blurred the distinction between monetary and fiscal policy especially as central banks globally now own over 20% of outstanding government debt! However, provided that the central bank has sufficient transparency and a detailed mandate to pursue its goals independently, then this 'conflict' should not arise.

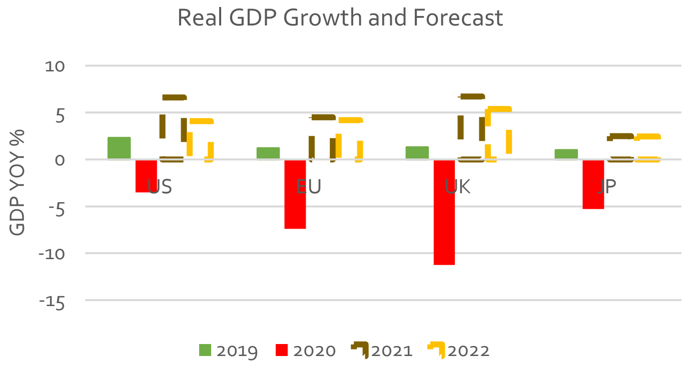
There have been more noises that suggest that the most recent actions during the pandemic may see the hiatus of central bank independence reached as it has highlighted some of the points above especially with the FED (and others) expected to announce some reversal of its stimulative QE policy this year. For critics of central bank independence to be silenced, then the unravelling/reversal of the QE programmes and other monetary induced stimulus will need to be handled in a very transparent way. It will need to avoid not only market disturbance/volatility but also ensure that the central banks targets are not ignored, and the economy is not 'harmed'. Should these unwinds prove unsuccessful, then the populist call may be to reign in the central banks' independence or at the very least re-examine their mandates.

[1] Haldane A: UCL Economists' Society Economics Conference - What has Central Bank Independence Ever Done for Us? 28 November 2020

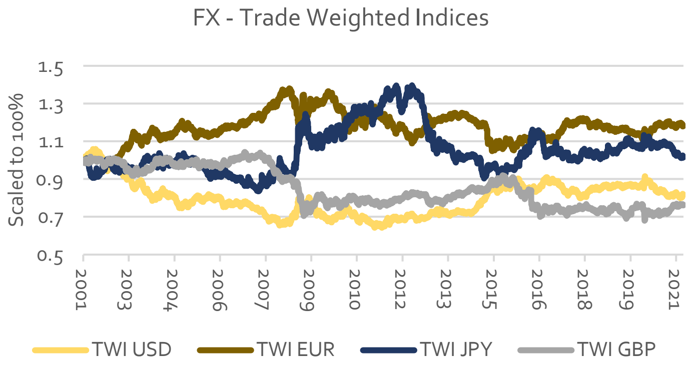
[2] Lawson N (1992) 'The View from No 11: Memoirs of a Tory radical '1060

[3] Dabelle G and S Fischer (1994) 'How Independent Should a Central Bank be?' pp195-221

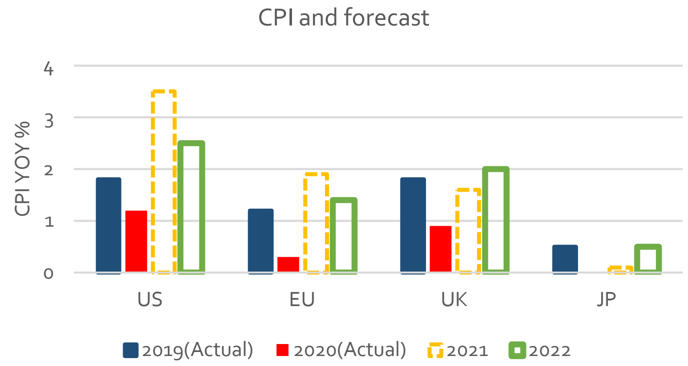
APPENDIX 1: ECONOMIC OUTLOOK



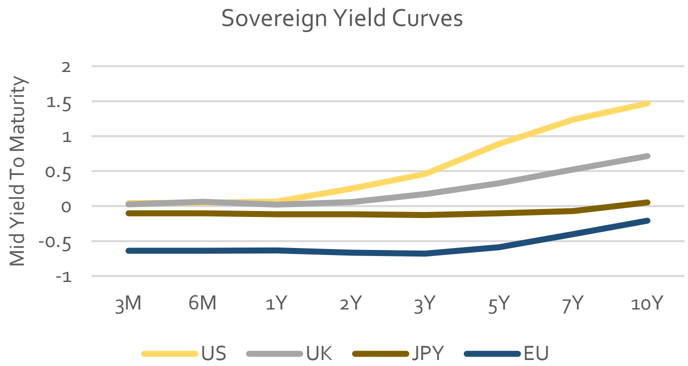
Real GDP growth forecasts are quite positive for 2021 due to basis effects and reopening of the economies.



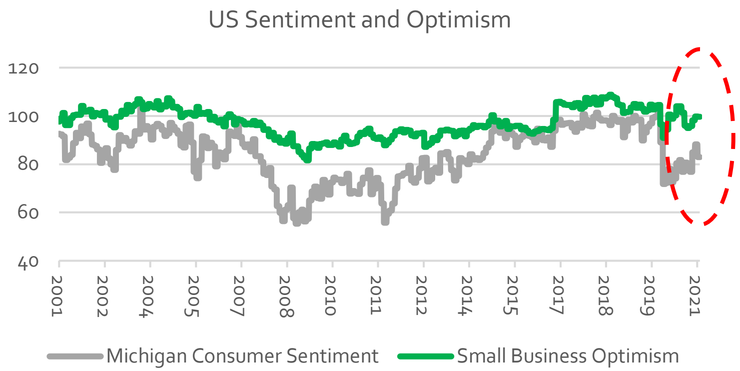
Trade weighted indices show a mixed picture.



Positive CPI expectations reflect basis impact from 2020 and supply bottlenecks.



Yield curves positively sloping reflect the money printed impact on the long term that may lead to inflation.



Consumer confidence and small business optimism on a recovery path.

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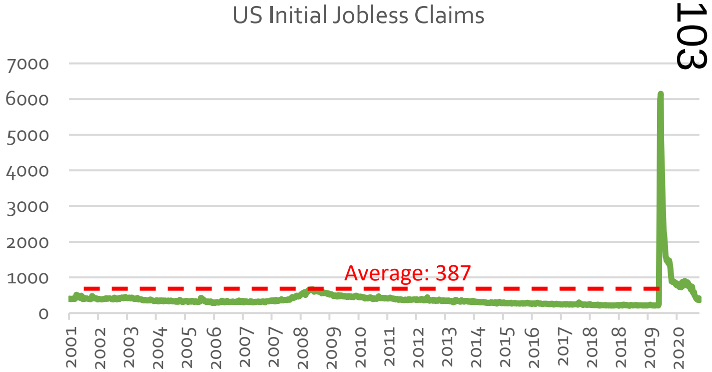

Initial jobless claims continued to normalize.

Source: Bloomberg, OECD, data as of 30/06/2021

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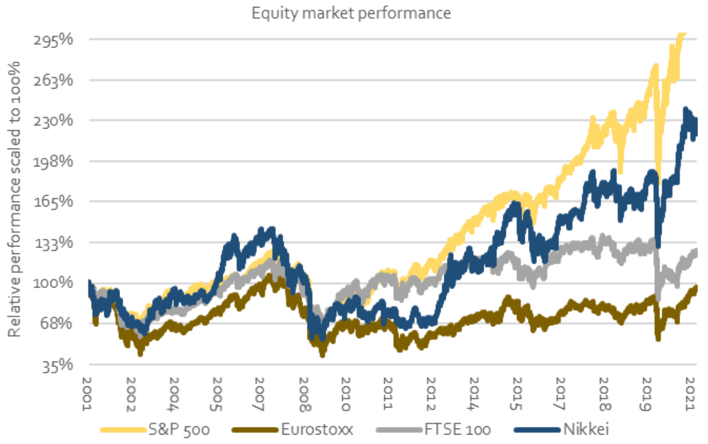
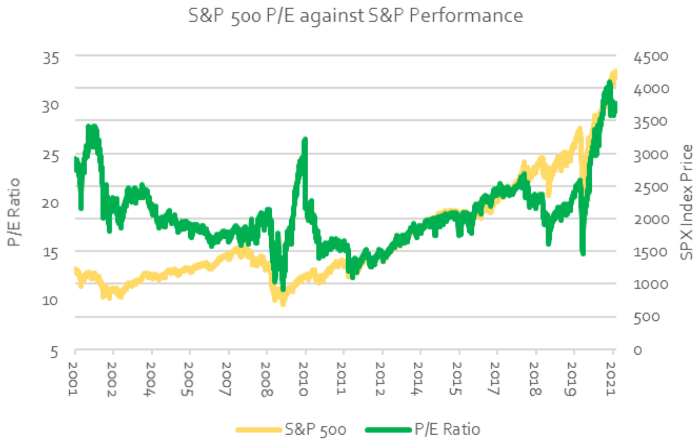
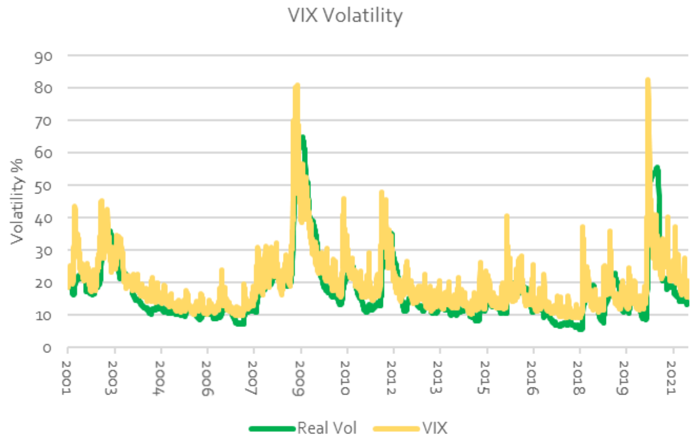


Markets have more than recovered as if there were no pandemic



P/E ratios reached new heights.



...VIX(fear) dropped...

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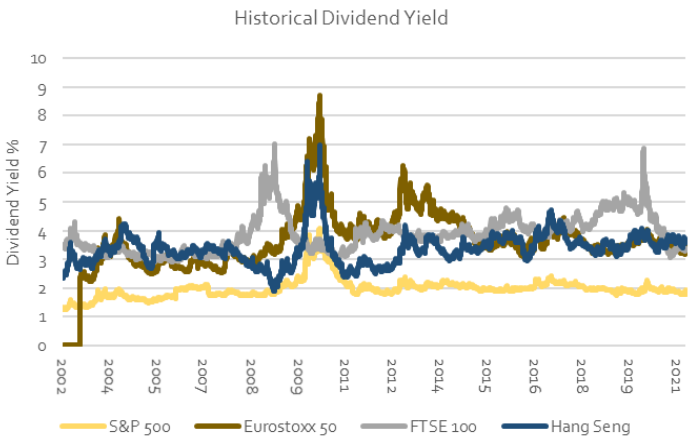
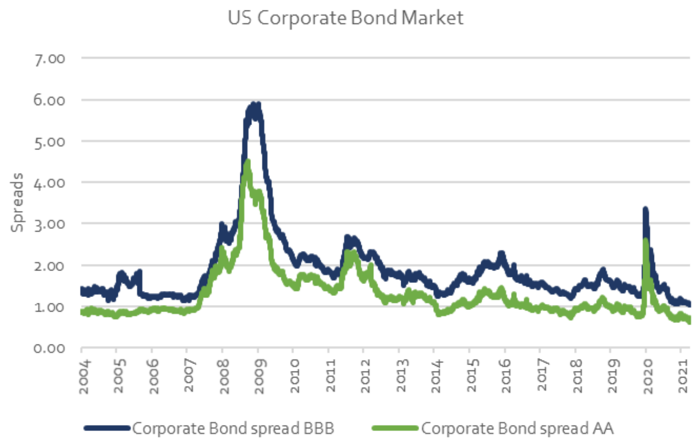
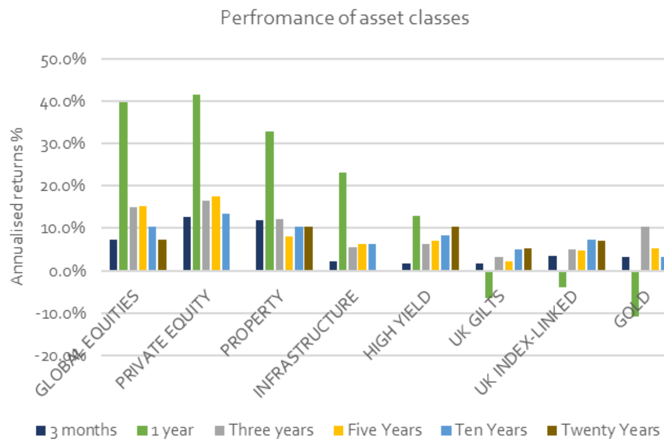


Dividend yields dropped as share prices rose.



Corporate bond spreads declined, following the FED purchase programme.



During Q2, property and private equity performed best.

Source: Bloomberg, OECD, data as of 30/06/2021

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APPENDIX 3: INVESTMENT IDEAS – MEET THE TEAM

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1 Selective Overweight Private Equity (J. Sidhu)

- Fundraising continues apace on the back of increasing private markets allocations (search for yield is leading investors to seek out new asset classes)
- Strong competition for quality assets, record levels of PE activity in H1 2021
- Strengthening £ makes overseas investments cheaper, but UK is also particularly attractive now following the 'conclusion' of Brexit
- Valuation concerns remain
- Pace of distributions remains robust

2 Neutral property (M. Hardwick)

- Lockdown easing boosting sentiment
- Glimmers of hope in retail but rental backlog needs addressing
- Positive talk around office but much of this from those with vested interest
- Transactional activity likely to rise, subject to usual August holiday season effects

3 Overweight Infrastructure (M. Hardwick)

- Investor demand remains high
- Inflation in the system should create even more demand for contractual inflation linkage
- Rising bond yields not causing any major concerns – for now
- Global need for infra rising, especially in light of environmental agenda

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4 Neutral Fixed Income (G. Ross)

- Gilt yields remain low in nominal and real terms providing unattractive returns
- Despite tight IG credit spreads, the global sector offers good relative income opportunities
- EM debt looks attractive on relative yield terms and provides added income potential
- MAC allocations offer attractive returns designed to outperform cash.

5 Neutral Equities (M. Davies)

- Following a strong first half to the year which has seen valuations increase, the level of potential upside from current levels has decreased
- However, we still see opportunities to invest in the equity markets on a selective basis across global markets
- Despite mixed messages from central banks, monetary policy is likely to remain favourable to markets in the near term
- Fiscal policy is also likely to be supportive with the potential for further stimulus measures to help markets
- Despite recent outperformance, we retain a preference for Value over Growth which we believe has further scope as economies reopen
- EM is preferred over DM on growth and valuation grounds

GLOSSARY:

GEMs	**Global Emerging Markets**
ESG	**Environmental, social and governance**
LTM	**Last twelve months**
IG	**Investment Grade**
VIX	**S&P Implied Volatility Index**
IPO	**Initial Public Offering**
OPEC	**Organisation of Petroleum Exporting Countries**
FAANG	**Facebook, Apple, Amazon, Netflix & Google**
UNPRI	**UN Principles for Responsible Investment**
YTD	**Year to date**
PE	**Private Equity**

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