

Shropshire Council
Monthly Investment Analysis Review
December 2014



Shropshire Council

Monthly Economic Summary

General Economy

Although December 2014 was a busy month, it was oil prices plummeting to a 5 year low, putting stress on energy exporting nations, that was most influential. The end of November saw shoppers rushing to the high street and online to make the most of the US styled Black Friday and Cyber Monday sales, pushing retail sales growth to a 10 year high. In addition, The Prudential Regulatory Authority (PRA) released the results of its stress tests of eight UK banks, with only the Co-operative Bank failing.

Growth in Manufacturing output fell to 0.7%, its biggest monthly decline since May. This was hit by a 4.5% fall in computer, electronic and optical products. Manufacturing Purchasing Managers' Index (PMI) rose marginally to 53.5 from 53.3 in October due to growth in new orders helping to push employment in the sector up to a four month high. The Construction PMI fell to 59.4 from 61.4, the weakest reading since October 2013. However, Britain's services sector expanded faster than expected last month, suggesting the economy may be slowing less than previously thought. The Services PMI rose to 58.6 after falling sharply to 56.2 in October, beating all market expectations. This rise in the index was the biggest in over a year and it has exceeded the 50 level that represents growth for nearly two years. The data showed that falling oil prices, which hit a five-year low, were helping firms to offset the effect of staff costs as hiring increased at its fastest rate since July.

Inflation fell for a third consecutive month to 1% in December, the lowest level seen in 12 years. This is partly due to the strength of sterling, which has helped by cutting the price of imports, as well as downward pressure from food and oil prices.

In the Autumn Statement, Chancellor George Osborne abolished the residential slab system so in future the stamp duty rates will only apply to the part of the property price that falls within their respective bands. As a result, stamp duty will be cut for the 98% of homebuyers who pay it. Multinational firms and banks will be taxed 25% on profits generated from economic activity in the UK which gets shifted out of the country.

The PRA tested the balance sheets of eight major UK Banks to see how they would fair against another economic down turn. The results of the test came as no surprise with the Co-operative Bank being the only bank to fail to meet the required capital ratio. The part-nationalised banks Lloyds and RBS only narrowly managed to pass but they are still too vulnerable for comfort. The European Banking Association also released stress test results in December with all four UK banks passing.

UK GDP in year on year terms was revised down to 2.6% for the third quarter, down from 3.0% in a previous estimate. However, the economy is showing positive signs with supermarket competition and cheap fuel prices, encouraging consumer spending. This is also supported by unemployment remaining stable at 6% and wages outstripping inflation, showing that Britain's economy still looks on course to expand at a strong pace in 2015.

Britain's goods trade deficit narrowed in October to its lowest level in seven months. The overall trade deficit narrowed to £2.02bn in October, down nearly £800m and hitting its lowest level since March. This was due to lower fuel imports and a slight rise in exports.

The UK saw US styled "Black Friday" discounts causing record sales growth as retail sales grew at their fastest annual rate in more than a decade in November. Retail sales grew 6.4% on the year which is the fastest annual growth since May 2004. This is due to downward pressure from falling food and oil prices and rising wages, which has resulted in consumers having more money to spend. The GfK consumer confidence index, however, edged down in December to its lowest level since March, as optimism about the economy hit a 17-month low.

The US economy grew to 5.0% annually, revised up from an original estimate of 3.9%, the fastest pace of growth since the third quarter of 2003. With a rapidly strengthening labour market and lower oil prices, there should be enough momentum to keep the Federal Reserve on course to start raising interest rates by the middle of 2015. Furthermore US employers added the largest number of workers in nearly three years with Nonfarm Payrolls rising by 321,000 last month. The unemployment rate remained at a six-year low, at 5.8%. This confirms that the economy is coping well despite slowdowns in China, the Eurozone and a recession in Japan.

Housing Market

Mortgage lender Nationwide reported that British house prices eased for a fourth consecutive month in December, slowing to 0.2% from 0.3%. Year on year house prices rose by 7.2% in December.

Forecast

Capita Asset Services kept its Bank Rate forecast unchanged this month, expecting the first increase in Q2 2015. Capital Economics did not alter their forecast this month

| Bank Rate | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 |
|-----------------------|--------|--------|--------|--------|--------|
| Capita Asset Services | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% |
| Capital Economics | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% |

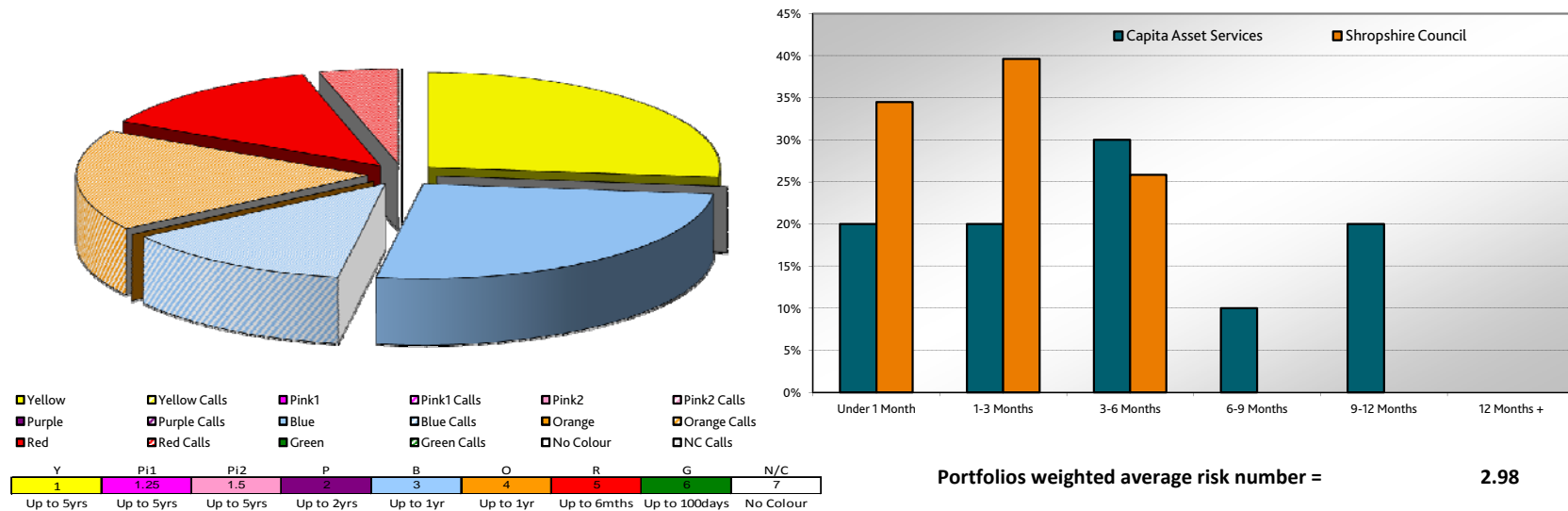
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Current Investment List

| | Borrower | Principal (£) | Interest Rate | Start Date | Maturity Date | Lowest Long Term Rating | Historic Risk of Default |
|--|---------------------------------------|---------------------|---------------|------------|---------------|-------------------------|--------------------------|
| | HSBC Bank Plc | 20,000,000 | 0.80% | | Call | AA- | 0.000% |
| | Lloyds Bank Plc | 4,320,000 | 0.95% | 09/01/2014 | 08/01/2015 | A | 0.002% |
| | Lloyds Bank Plc | 3,600,000 | 0.57% | 06/10/2014 | 09/01/2015 | A | 0.002% |
| | Nationwide Building Society | 2,100,000 | 0.50% | 13/10/2014 | 13/01/2015 | A | 0.003% |
| | Nationwide Building Society | 2,000,000 | 0.50% | 22/10/2014 | 20/01/2015 | A | 0.005% |
| | Lancashire County Council | 5,000,000 | 0.50% | 22/07/2014 | 22/01/2015 | AA+ | 0.001% |
| | Barnsley Metropolitan Borough Council | 3,000,000 | 0.42% | 17/11/2014 | 30/01/2015 | AA+ | 0.001% |
| | Nationwide Building Society | 2,900,000 | 0.50% | 05/11/2014 | 02/02/2015 | A | 0.008% |
| | Nationwide Building Society | 3,000,000 | 0.50% | 03/11/2014 | 03/02/2015 | A | 0.008% |
| | Barclays Bank Plc | 5,000,000 | 0.56% | | Call35 | A | 0.008% |
| | Lincolnshire County Council | 3,000,000 | 0.40% | 15/10/2014 | 06/02/2015 | AA+ | 0.002% |
| | Barclays Bank Plc | 3,250,000 | 0.51% | 05/11/2014 | 06/02/2015 | A | 0.009% |
| | Lloyds Bank Plc | 1,400,000 | 0.57% | 07/11/2014 | 10/02/2015 | A | 0.010% |
| | Lloyds Bank Plc | 900,000 | 0.57% | 10/11/2014 | 11/02/2015 | A | 0.010% |
| | Barclays Bank Plc | 1,750,000 | 0.51% | 11/11/2014 | 11/02/2015 | A | 0.010% |
| | Lloyds Bank Plc | 1,520,000 | 0.95% | 13/02/2014 | 12/02/2015 | A | 0.010% |
| | Birmingham City Council | 5,000,000 | 0.45% | 15/08/2014 | 16/02/2015 | AA+ | 0.002% |
| | Cornwall Council | 5,000,000 | 0.45% | 03/09/2014 | 03/03/2015 | AA+ | 0.003% |
| | Birmingham City Council | 5,000,000 | 0.50% | 03/12/2014 | 03/03/2015 | AA+ | 0.003% |
| | Lloyds Bank Plc | 5,000,000 | 0.95% | 07/03/2014 | 06/03/2015 | A | 0.015% |
| | Lloyds Bank Plc | 3,260,000 | 0.95% | 02/04/2014 | 01/04/2015 | A | 0.022% |
| | National Westminster Bank Plc | 15,000,000 | 0.30% | | Call95 | BBB+ | 0.052% |
| | Lloyds Bank Plc | 5,000,000 | 0.95% | 09/04/2014 | 08/04/2015 | A | 0.023% |
| | Lloyds Bank Plc | 5,000,000 | 0.95% | 17/04/2014 | 16/04/2015 | A | 0.025% |
| | Lancashire County Council | 5,000,000 | 0.58% | 01/10/2014 | 01/07/2015 | AA+ | 0.008% |
| | Total Investments | £116,000,000 | 0.62% | | | | 0.013% |

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Portfolio Breakdown by Capita Asset Services' Suggested Lending Criteria



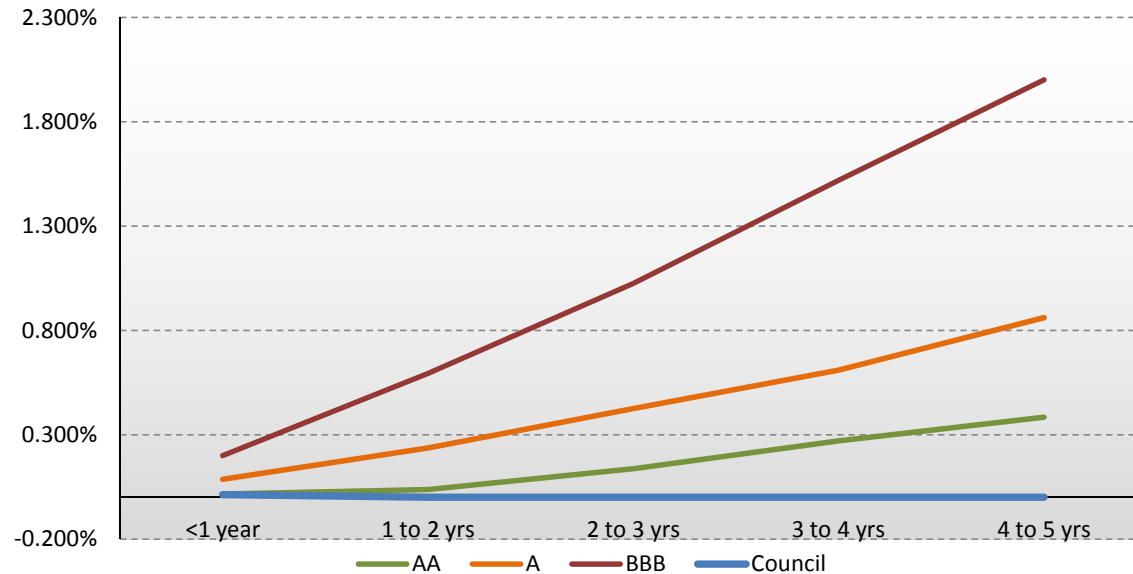
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

| | % of Portfolio | Amount | % of Colour in Calls | Amount of Colour in Calls | % of Call in Portfolio | WARoR | WAM | WAM at Execution | Excluding Calls/MMFs/EMMFs WAM | Excluding Calls/MMFs/EMMFs WAM at Execution |
|--------------|----------------|---------------------|----------------------|---------------------------|------------------------|--------------|-----------|------------------|--------------------------------|---|
| Yellow | 26.72% | £31,000,000 | 0.00% | £0 | 0.00% | 0.48% | 67 | 165 | 67 | 165 |
| Pink1 | 0.00% | £0 | 0.00% | £0 | 0.00% | 0.00% | 0 | 0 | 0 | 0 |
| Pink2 | 0.00% | £0 | 0.00% | £0 | 0.00% | 0.00% | 0 | 0 | 0 | 0 |
| Purple | 0.00% | £0 | 0.00% | £0 | 0.00% | 0.00% | 0 | 0 | 0 | 0 |
| Blue | 38.79% | £45,000,000 | 33.33% | £15,000,000 | 12.93% | 0.68% | 73 | 239 | 62 | 311 |
| Orange | 17.24% | £20,000,000 | 100.00% | £20,000,000 | 17.24% | 0.80% | 0 | 0 | 0 | 0 |
| Red | 17.24% | £20,000,000 | 25.00% | £5,000,000 | 4.31% | 0.52% | 32 | 77 | 31 | 91 |
| Green | 0.00% | £0 | 0.00% | £0 | 0.00% | 0.00% | 0 | 0 | 0 | 0 |
| No Colour | 0.00% | £0 | 0.00% | £0 | 0.00% | 0.00% | 0 | 0 | 0 | 0 |
| Total | 100.00% | £116,000,000 | 34.48% | £40,000,000 | 34.48% | 0.62% | 52 | 150 | 58 | 208 |

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Investment Risk and Rating Exposure

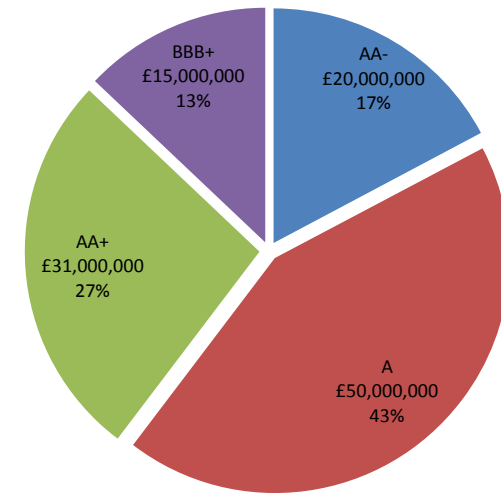
Investment Risk Vs. Rating Categories



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 | 0.017% | 0.038% | 0.137% | 0.271% | 0.384% |
| A | 0.087% | 0.237% | 0.425% | 0.610% | 0.861% |
| BBB | 0.201% | 0.595% | 1.025% | 1.519% | 2.000% |
| Council | 0.013% | 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 |
|------------|---------------|-------------------------|---------|--|
| 15/12/2014 | 1316 | France Sovereign Rating | France | Downgraded to 'AA' from 'AA+', removed from 'Negative Watch' and placed on a 'Stable' Outlook. |

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Monthly Credit Rating Changes MOODY'S

| Date | Update Number | Institution | Country | Rating Action |
|------------|---------------|--|-------------|---|
| 02/12/2014 | 1313 | Sumitomo Mitsui Banking Corporation Europe Ltd | UK | Moody's downgraded the Long Term Rating to 'A1' from 'Aa3', placed on a Stable Outlook. Affirmed Short Term Rating at 'P-1'. The Financial Strength Rating remained at 'C' with a Stable Outlook. |
| 19/12/2014 | 1318 | HSBC Bank USA, N.A. | U.S.A | Affirmed Long Term Rating at 'A1', 'Stable' Outlook. Affirmed Short Term Rating at 'P-1'. Affirmed Financial Strength Rating at 'C-', Outlook changed to 'Stable' from 'Negative'. |
| 19/12/2014 | 1319 | ING Bank NV | Netherlands | Affirmed Long Term Rating at 'A2', 'Negative' Outlook. Affirmed Short Term Rating at 'P-1'. Affirmed Financial Strength Rating at 'C-', Outlook changed to 'Stable' from 'Negative'. |

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Monthly Credit Rating Changes S&P

| Date | Update Number | Institution | Country | Rating Action |
|------------|---------------|-------------------------------|--------------|---|
| 02/12/2014 | 1314 | Bank of America, N.A. | U.S.A | Affirmed the Long Term Rating at 'A', Outlook changed to 'Stable' from 'Negative'. Affirmed the Short Term Rating at 'A-1'. |
| 02/12/2014 | 1314 | Merrill Lynch International | UK | Affirmed the Long Term Rating at 'A', Outlook changed to 'Stable' from 'Negative'. Affirmed the Short Term Rating at 'A-1'. |
| 05/12/2014 | 1315 | Saudi Arabia Sovereign Rating | Saudi Arabia | Affirmed at 'AA-', Outlook changed to 'Stable' from 'Positive'. |
| 17/12/2014 | 1317 | Arab National Bank | Saudi Arabia | Affirmed at 'A', Outlook changed to 'Stable' from 'Positive', Short Term Rating Affirmed at 'A-1'. |