September 2022

XPS Investment News

Bringing you our market round-up and the latest news affecting UK pension scheme investments

Month in brief

- The aggregate funding position of UK DB Pension Schemes reached 100% on a low risk basis at the end of the month, propelled by rising gilt yields
- UK inflation hit double digits for the first time since 1982 as UK consumer confidence hits all-time low
- The US Federal Reserve warns of further rate hikes to come
- The UK imported no fossil fuel from Russia for the first time on record in June as it plans to completely phase out its reliance on Russian energy by the end of 2022

Thomas Pawelski
Investment Consultant

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Thomas' September update

UK pension schemes have never been better funded despite inflation headwinds

In August, the Office for National Statistics reported that the Consumer Prices Index climbed to 10.1% in the 12 months to July.

This was slightly higher than market analysts had predicted and the Bank of England is forecasting a peak of around 13% in October this year driven by the increase in the energy price cap which will see around 24 million UK households facing annual energy bills of more than £3,500. Some industry experts have predicted an inflation rate as high as 18% by early next year.

Consumer confidence in the UK hit its lowest level on record in August with the Bank of England predicting that the UK will fall into a recession that is expected to last until the end of 2023. The Monetary Policy Committee is widely expected to continue to raise interest rates in its attempts to combat seemingly uncontainable price inflation which is set to trigger a period of prolonged negative economic growth. The pound suffered its worst month since the aftermath of the Brexit result as concerns mounted over the outlook for the economy.

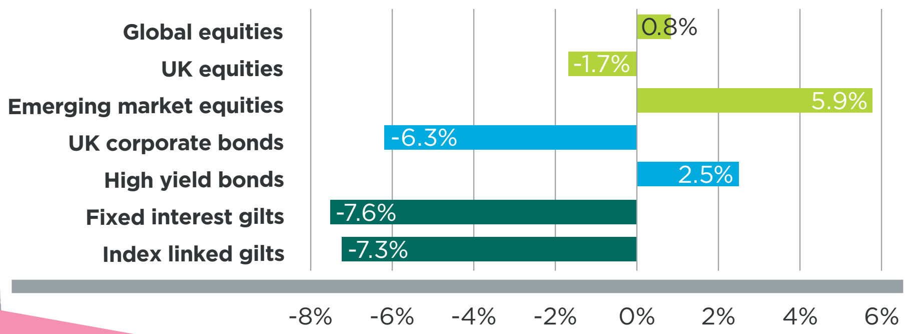
Liz Truss was announced as the next Prime Minister of the United Kingdom on 5 September beating Rishi Sunak in the Conservative party leadership election. The deepening cost of living crisis is undoubtedly the greatest challenge of her early premiership.

In the US, Federal Reserve Chairman Jerome Powell said the Fed will need to act forcefully in an attempt to restore price stability. His comments saw US stocks tumble despite somewhat positive news that US inflation had fallen to 8.5% in July – down from 9.1% in June.

The Asian stock market also fell on the back of Powell's comments against a backdrop of concerns over the Chinese economic slowdown. China has seen multiple Covid lockdowns across major manufacturing cities and now faces a

Gilt yields rose causing the value of gilts to fall significantly

One Month to 31 August 2022



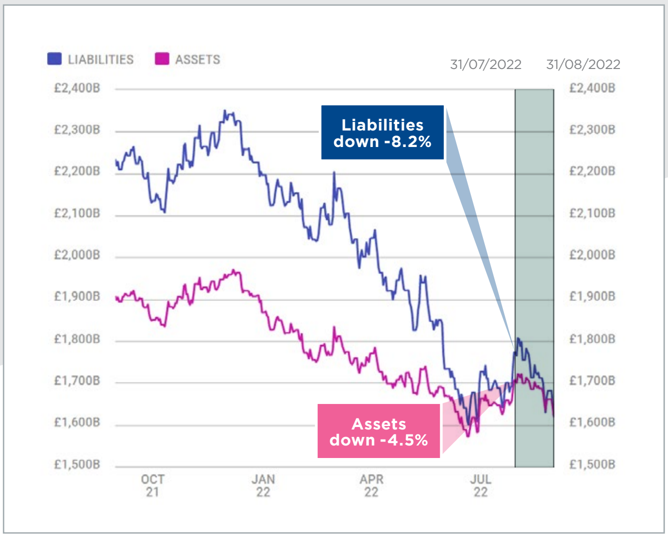
Source: Refinitiv Datastream

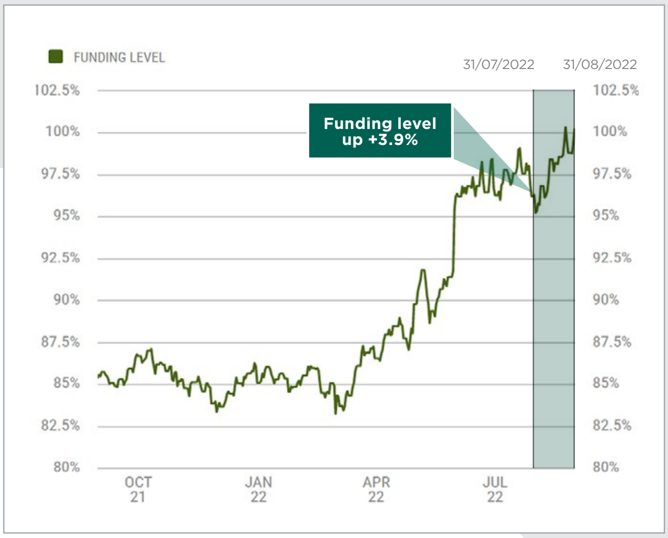
deepening property crisis. The People's Bank of China made a rare move to cut its mortgage rate during the month in an attempt to revitalise its real estate market.

For the first time on record, the UK did not import any fossil fuel from Russia in June as global efforts continue to remove reliance on Russian oil and gas. Russia shut off the Nord Stream 1 pipeline again in August citing maintenance requirements. This was the second time in two months and has caused heightened tensions with Germany – the largest importer of Russian oil and gas in Europe.

August was a mixed month for major asset class performance. Global and emerging market equities finished in positive territory for UK investors with returns having been bolstered by Sterling's depreciation. UK equity returns struggled in absence of this boost. High yield bonds have had a difficult year so far but managed to recover some ground in August. Gilt yields rose sharply over the month, which saw fixed interest gilts deliver negative performance. Index-linked gilts also finished down on July.

The aggregate funding position of UK DB Pension Schemes reached 100% on a low risk basis in August. Rising gilt yields in the year to-date have led to funding level improvements for Schemes that do not fully hedge their liabilities. This presents a significant milestone for the pensions industry and provides scope for de-risking, despite the challenging economic backdrop.





Source: XPS DB:UK www.xpsgroup.com/services/xps-pensions/xps-dbuk-funding-watch

The charts above are based on data from The Pensions Regulator, the PPF 7800 Index and the XPS data pool. The assumptions used in the UK:DB long-term target basis include a discount interest rate of gilt yields plus 0.5%. The assumed asset allocation is 16.9% equities, 20.0% corporate bonds, 6.9% multi-asset, 5.1% property, 3.8% private markets and 47.3% in liability driven investment (LDI) with the LDI overlay providing a 60% hedge on inflation and interest rates.

To discuss any of the issues covered in this edition, please get in touch with Thomas Pawelski.

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