March
2023

XPS Investment News

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

Month in brief

- Sharply rising gilt yields and stable inflation expectations saw UK DB pension scheme liabilities fall in February as funding improved
- Inflation is reducing modestly but the UK Consumer Prices Index was still over 10% in January
- The Bank of England increased the Bank rate from 3.5% to 4.0% at the start of February
- The FTSE 100 hit new highs in February but global equities struggled to keep pace whilst the US economy continues to defy fears of recession

Emma Coleman
Senior Associate

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Emma's March update

Sharply rising gilt yields sees pension scheme funding on the rise in February

Fixed and real yields rose sharply but overall this was positive for pension scheme funding. Peak inflation seems to have passed but inflationary headwinds are expected to persist.

The Bank of England increased the Bank rate by 0.5% to 4.0% at the start of February in pursuit of controlling inflation. UK CPI fell modestly for the third consecutive month in the 12 months to January, down 0.4% on the previous month to 10.1%. However further inflationary headwinds are still anticipated with food inflation rising once again in February. Russia's deputy prime minister, Alexander Novak, announced that Russia will cut oil production by 500,000 barrels per day from March in direct retaliation to western countries capping how much they will offer to pay for oil and refined products. The news pushed the price of Brent crude oil up by 2.2% to $86 per barrel in the immediate aftermath of the announcement.

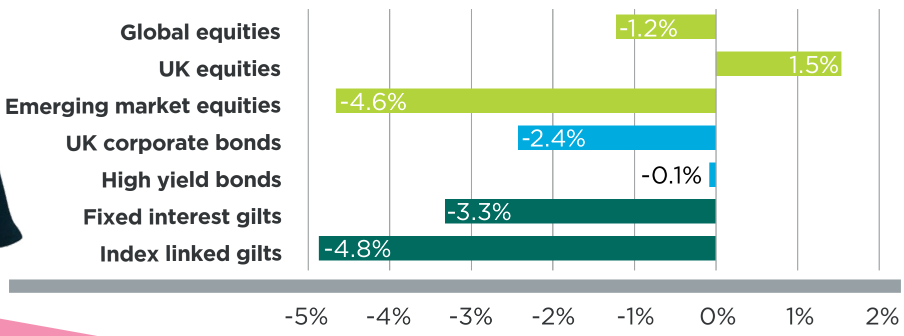
Despite significant spending on household energy support in January, the UK government announced an unexpected surplus in public finances of £5.4bn during the month – much to the surprise of analysts. Borrowing in the current financial year is £30bn less than the Office for Budget Responsibility had previously predicted.

Inflation in the US also fell for a third consecutive month to 6.4% but the deceleration was slower than hoped falling by just 0.1% on the prior month's 12 month figure. The US Federal Reserve announced an increase in interest rates of 0.25% at the start of February with the European Central Bank increasing rates by 0.5%. Markets had previously priced in two US interest rate cuts before the end of 2023 but now suggest that no cuts are expected for the remainder of the year.

In Asia, Kazuo Ueda was named as

UK equities performed strongly over the month

One Month to 28 February 2023



Source: Refinitiv Datastream

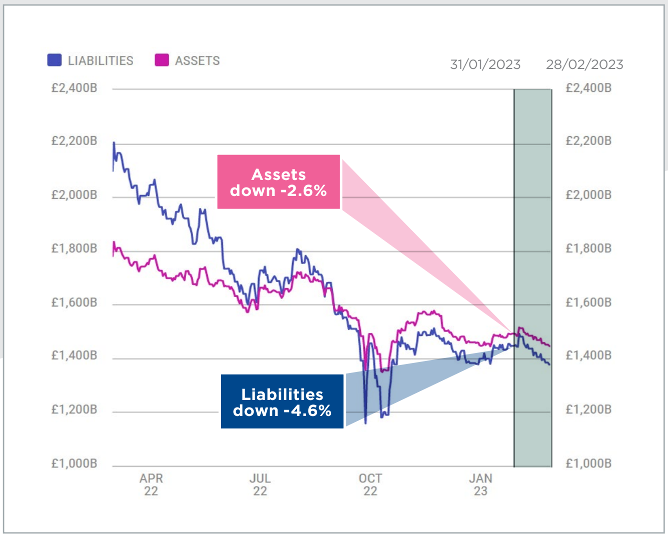
the next Governor of the Bank of Japan. The world's third largest economy has been struggling with 40-year high inflation and slower than expected economic growth since the pandemic.

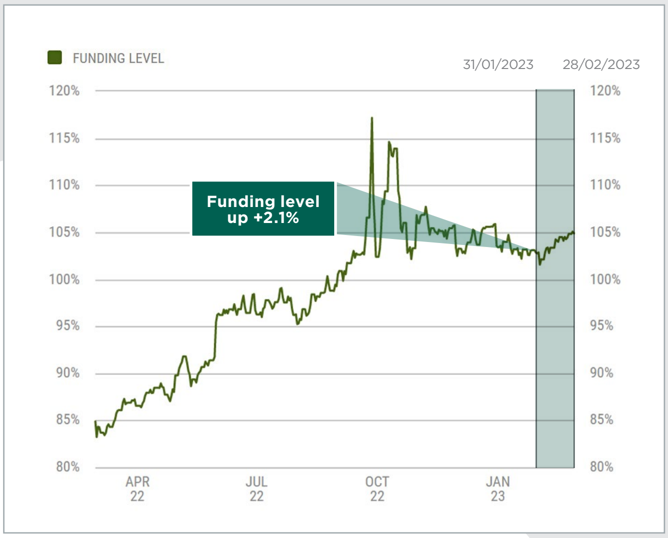
Chinese manufacturing expanded at the fastest rate in over a decade in February in an early indication that the world's second largest economy was beginning to shake off the impact of its zero-Covid policy.

UK equities posted strong returns over the month as investors speculated that a weakening Pound would make UK exports more competitive on international markets. Sterling dropped in value from $1.23 to $1.20 over the month whilst the FTSE 100 recorded an all-time high mid-month, almost five years on from its previous peak in May 2018.

On the other hand, global and emerging market equities posted negative returns to sterling investors. Gilt yields rose steadily over February as corporate bonds, fixed interest gilts and index-linked gilts all posted negative returns. Expectations for changes in future inflation remained broadly unchanged.

Aggregate UK DB pension scheme funding on a low risk basis improved in February. Liabilities fell by more than assets during February leading to aggregate funding gains.





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 Emma Coleman.

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