April
2023

XPS Investment News

Bringing you the latest investment news, insights and opinion from across the pensions industry

Quarter in brief

- **The near collapse of Credit Suisse in the aftermath of Silicon Valley Bank and Signature Bank raised fears of a banking crisis in March**
- **The Bank of England and Federal Reserve both continued to grapple with inflation, raising interest rates by 75bps and 50bps respectively over the quarter**
- **Pension scheme funding levels fell slightly over the quarter as strong but choppy growth returns were not enough to offset falling gilt yields**

Alasdair Gill
Head of Equities

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Alasdair's April update

Markets rally in Q1 despite turmoil in the banking sector over March

Following the collapse of Silicon Valley Bank and Signature Bank in the US, the near collapse of Credit Suisse had threatened to undermine the strength of the global banking sector.

The $3bn deal for UBS to purchase Credit Suisse combined with wider industry support from central banks was relatively successful in reassuring markets. Federal Reserve Chairman Jerome Powell and Treasury Secretary Janet Yellen issued a joint statement to welcome UBS' purchase of Credit Suisse as a move that would "support financial stability". The Bank of England was also positive on the takeover adding that "the UK banking system is well capitalised and funded, and remains safe and sound". After sharp falls in banking shares around the world, investors responded well to the reassurance from central banks as stock markets rebounded towards the end of the quarter, driven by a rally in the shares of the largest banks.

After 3 consecutive months of falls, many were surprised to learn that the UK Consumer Prices Index had risen 0.3% in February to 10.4%. The familiar drivers of rising household energy costs and food prices were the biggest contributors to the increase but a study by the Centre for European Reform suggested that worker shortages in the transport, hospitality and retail sectors in particular were driving up wages and hence also contributing to rising prices. The Governor of the Bank of England, Andrew Bailey, branded the surprise increase in inflation as the result of "one off elements" adding that the Bank expects inflation to come down sharply over the summer. The Governor's comments came as the Monetary Policy Committee voted to raise the Bank rate by 0.25% in March taking the total increase over Q1 2023 to 0.75%.

The Federal Reserve also decided to raise interest rates by 0.25% to a range of 4.75% - 5.0% in March, an increase of 0.5% over the quarter. Investors had speculated over whether turmoil in the banking sector would influence the decision to raise interest rates but Chairman Powell confirmed that this was not a primary factor in the Fed's decision due to the underlying resilience of the US banking sector. He welcomed the news that 12-month inflation had fallen by 0.4% to 6.0% in February but the market continues to price in further rate hikes to a peak of 5.25% - 5.5% by the end of 2023 as Fed continues to wage its fight against inflation.

The European Central Bank (ECB) voted to raise interest rates by a further 0.5% in March to 3.5% following on from a 0.5% increase in February. The ECB has raised interest rates more aggressively than other central banks in recent months, having kept rates lower for longer in 2022 as it tapered down its asset purchase programme. The ECB is on track for further rate rises in 2023 despite 12-month inflation falling steeply in March from 8.5% to 6.9% due to a continued acceleration of "core" inflation which excludes energy and food prices.

Global equities were up over March to finish the quarter strongly. On the other hand, UK equities were down in the final month of the quarter, but still posted decent returns over Q1. UK corporate bonds fared well over the quarter, aided by falling long-term yields. However widening credit spreads, mostly over March, detracted from returns. Long-term inflation expectations were broadly flat over the quarter. Both fixed interest and index-linked gilts posted positive returns over the quarter, due to yields falling in March.

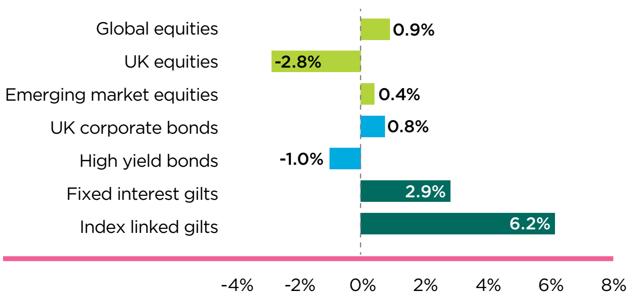
In late March, the Bank of England's Financial Policy Committee announced that it was recommending the Pensions Regulator should specify minimum levels of resilience for schemes using Liability Driven Investment, working in collaboration with the FCA and pooled fund regulators. It specified a minimum level of immediate capital buffer to absorb bond yield rises of 2.5%, with additional capital needing to be available within 5 days. This wasn't unexpected but removes any doubt that tighten regulation around use of leverage is coming.

Aggregate UK DB pension scheme funding is estimated to have fallen over the quarter, with positive but choppy gains from growth assets not enough to offset the impact of falling gilt yields serving to increase the value of long-term liabilities. The fall was modest however and schemes are expected to remain in surplus on a low risk basis in aggregate at the quarter end.

After sharp falls in banking shares around the world, investors responded well to the reassurance from central banks as stock markets rebounded towards the end of the quarter, driven by a rally in the shares of the largest banks.

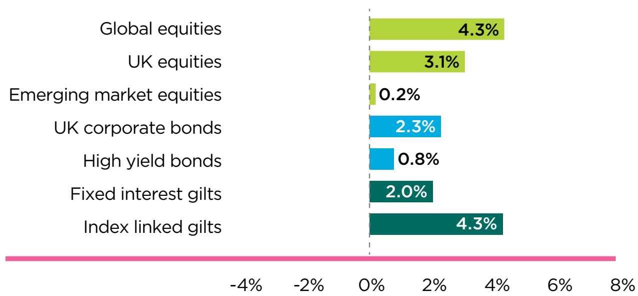
Market returns

1 month to 31 March 2023



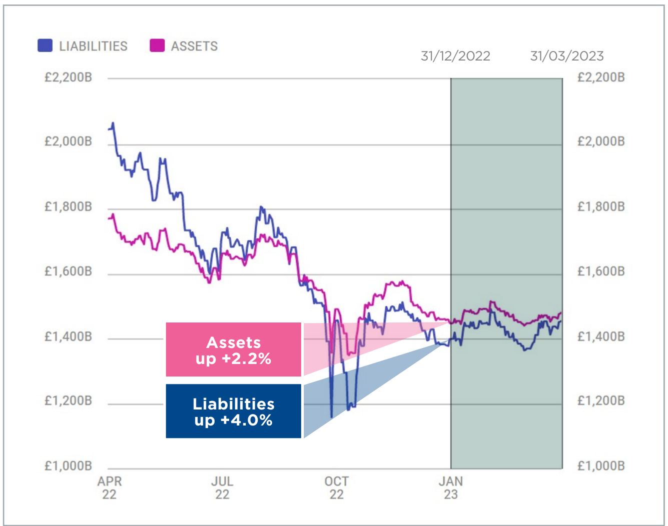
Source: Refinitiv

3 months to 31 March 2023

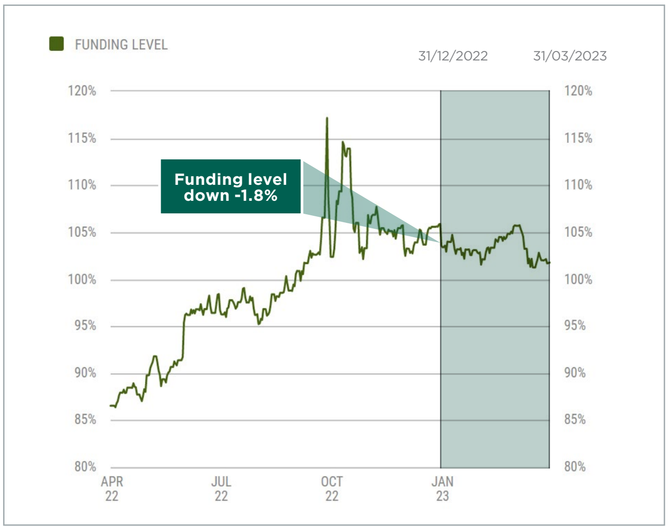


Source: Refinitiv

Asset and liability progression
for the DB:UK universe



Funding level progression
for the DB:UK universe



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.

XPS Investment asset class views

Asset class	Favourable	Neutral	Unfavourable	Movement
Developed equities	●			↑
Emerging market equities		●		
Investment grade corporate bonds		●		
High yield bonds		●		
Senior secured direct lending	●			↑
Balanced property (UK)		●		
Long lease property	●			↑
Diversified private markets	●			
Secure income		●		
Private equity	●			↑
Equity option strategies	●			
Pensioner buy-in	●			
Cash		●		

Find out more

To discuss any of the issues covered in this edition, please get in touch with Simeon Willis or Alasdair Gill:

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