June
2023

XPS Investment News

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

Month in brief

- Gilt yields rose by 0.4% leading to funding level improvements for many schemes
- UK CPI inflation fell by 1.4% to 8.7% in April but ‘core’ inflation is still rising
- The IMF has upgraded its forecast for the UK economy which it predicts will now avoid recession in 2023
- Late in the month, a key milestone was reached in raising the US debt ceiling which had threatened to wreak havoc on the global economy

Matthew Jarvis
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Matthew’s June update

Gilt yields climb over May as inflation is proving tough to beat

Despite the Consumer Prices Index (CPI) falling from 10.1% to 8.7% according to the latest figures, inflation is still a major concern for the Bank of England who are predicted to raise rates again when they meet in June.

Core inflation, which excludes food and energy prices, rose to a 31-year high in the 12-months to April signalling that inflation remains stickier than hoped despite falling wholesale energy prices in recent months. The Bank of England looks set to raise the bank rate again later this month in response, with the market predicting that interest rates in the UK will now peak at 5.5% by the end of 2023. The Bank has already raised interest rates 12 times in a row, most recently to 4.5% at its May meeting.

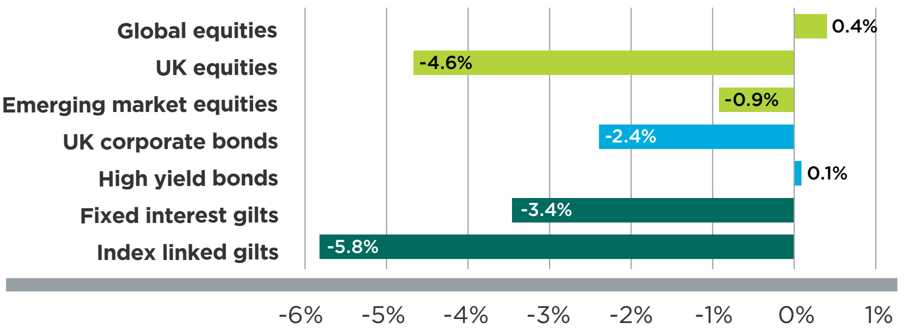
Despite noting that inflation in the UK “remains stubbornly high”, the International Monetary Fund (IMF) revised its growth forecast for the UK during May and now predicts the economy will grow by 0.4% compared to its previous estimate of a 0.3% contraction. The outlook for beyond the end of 2023 also improved but remained subdued with growth forecasts of 1% in 2024 and 2% in 2025 and 2026.

However, the UK economy grew by just 0.1% in the first quarter of 2023, having contracted by 0.3% in March, and remains 0.5% smaller than before the Covid-19 pandemic according to the Office for National Statistics.

In the US, a significant milestone in the scramble to raise the debt ceiling was reached at the very end of the month. The House of Representatives overwhelmingly approved a measure to avoid the world’s largest economy defaulting on its $31.4 trillion of borrowing. A default on US debt

Global equities were the strongest performer over the month

One Month to 31 May 2023



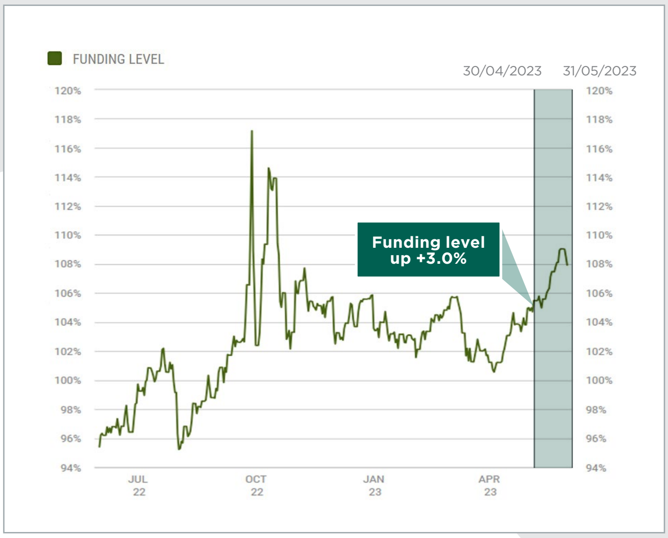
Source: Refinitiv Datastream

would threaten to undermine the entire global economy as US debt is widely seen as the safest asset against which the risk premium of every other global asset is benchmarked.

May was a tough month for equity markets on the whole. Global equities posted modest positive returns as threats of a global recession still loom but earnings continued to be resilient. The UK stock market fared less well as major energy stocks slid in response to falling oil prices. Emerging markets lagged again and are down almost 10% in 2023 thus far. UK corporate bond returns were hindered by rising interest rates but high yield bonds were marginally up in what has been a tough year-to-date for the asset class.

Sticky inflation in the UK came as a surprise to investors, driving up gilt yields, with the market now expecting interest rates to rise again in June and stay higher for longer as the Bank of England continues to combat rising prices. This led to negative returns for fixed interest and index linked gilt investors.

Long-dated nominal and real gilt yields climbed by around 0.4% over May which in turn led to a significant reduction in the value of aggregate UK DB pension scheme liabilities. This more than offset negative returns from growth assets to lead to an improvement in aggregate funding on a low risk position over the month.



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 Matthew Jarvis.

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Alternatively, please speak to your usual XPS Investment contact.

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