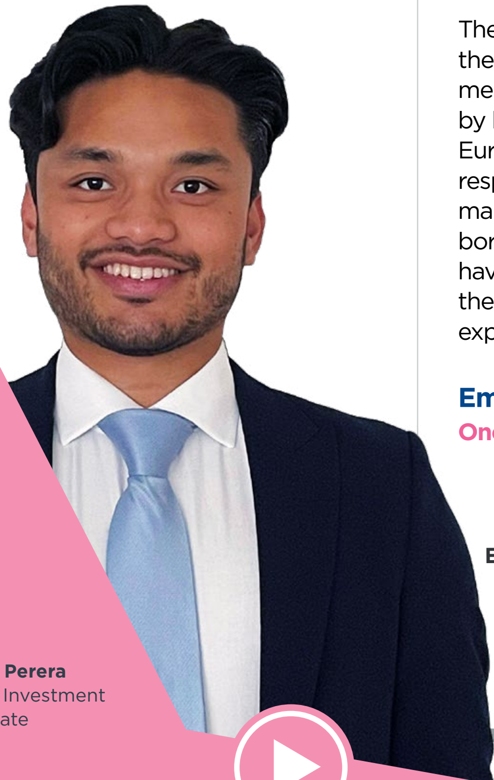
August
2023

XPS Investment News

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

Month in brief

- 12-month CPI fell by 0.8% over June from 8.7% to 7.9% which was a greater fall than expected
- The Bank of England remains concerned about record wage growth continuing to fuel inflation
- US economic growth over Q2 surpassed expectations spurred on by a jump in business investment
- Aggregate UK DB pension scheme funding rose marginally driven by growth asset returns



James Perera
Senior Investment Associate

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James' August update

Major equity markets rally off the back of encouraging outlook

Despite a welcome and unexpected fall in the 12-month Consumer Prices Index (CPI) over June, inflation in the UK remains significantly higher than in other G7 economies and is expected to do so for some time.

12-month CPI fell from 8.7% to 7.9% in June which was welcome news, although inflation in the UK is still 1.5% higher than in Germany and almost 5% higher than in the US. In contrast, long term inflation expectations were broadly unchanged over the month of July.

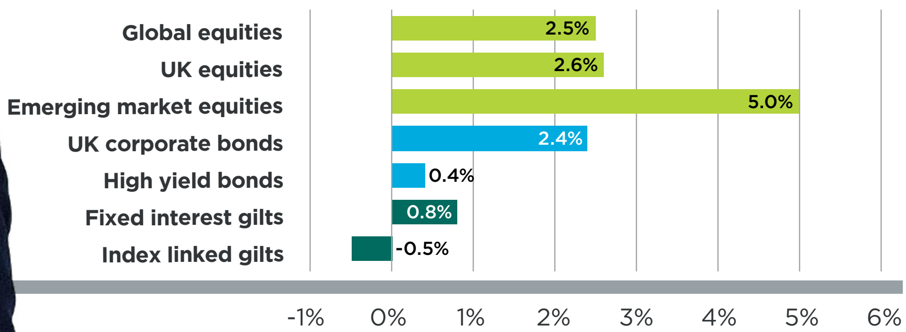
The Bank of England voted to raise the bank rate by 0.25% at its August meeting to 5.25% following decisions by both the Federal Reserve and European Central Bank to raise their respective interest rates by the same margin in July. There were signs that borrowing costs in the US and EU may have peaked but this is less likely to be the case in the UK where inflation is expected to persist.

A key reason for this stubbornness is likely to be an especially tight labour market in the UK. The Communication Workers Union and National Education Union, representing postal workers and teachers respectively, accepted deals to end long-running pay disputes in July.

Fears of a looming slow down for the US economy were once again defied after it emerged it had unexpectedly grown by 2.4% over the second quarter. Confidence grew that the Federal Reserve can deliver a "soft landing" by lowering inflation back to target without pushing the economy into recession.

US Treasury Secretary Janet Yellen held "substantive and productive" talks with China during a trip in July widely seen

Emerging market equities were the strongest performer over the month
One Month to 31 July 2023

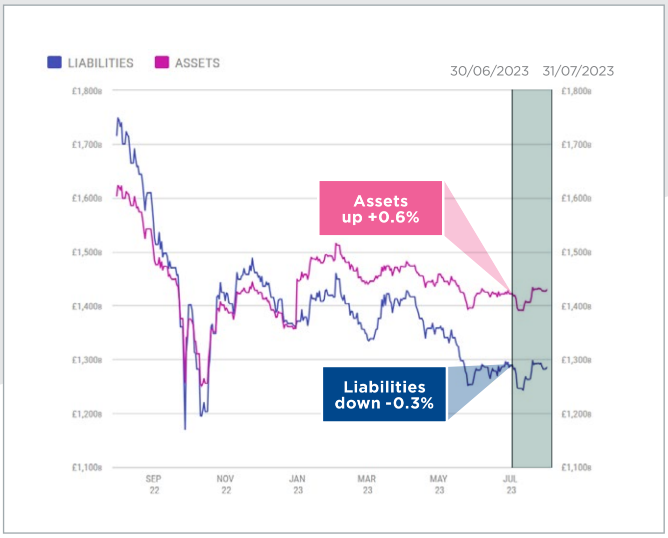


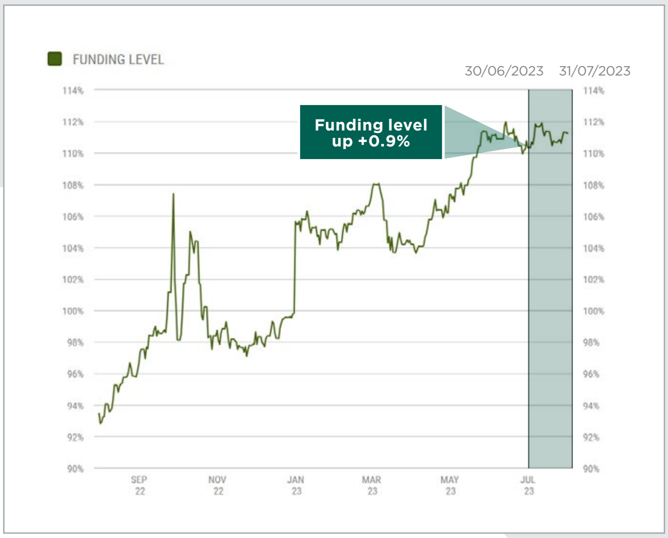
Source: Refinitiv Datastream

as an effort to rebuild the deteriorating relationship between the two global superpowers.

Equity markets struggled in the first week of July off the back of strong jobs data in the US implying a need for greater interest rate increases to curb inflation. Subsequent inflation data proved more encouraging and prompted a rally in the major equity markets. UK equities outperformed slightly with property groups and housebuilders among the biggest winners from the surprising drop in UK inflation during July. Emerging market equities posted a particularly strong month after mixed returns in the first half of the year thanks to strong performance from tech-related industries that make up a significant proportion of emerging market indices. Corporate bonds shared in the market rally with a noticeable tightening in credit spreads over July.

UK government bond performance was mixed with relatively flat returns over the month for fixed interest gilts and index-linked gilts. Schemes in the main will not have experienced significant changes in funding levels, with aggregate UK DB pension scheme funding on a low-risk basis up slightly over the month thanks to modest positive asset growth.





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 James Perera.

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Alternatively, please speak to your usual XPS Investment contact.

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