April
2024

XPS Investment News

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

Quarter in brief

- **An 'AI boom' in February was the catalyst behind a widespread rally for global equities in Q1 2024**
- **Expectations remain for US and UK interest rates to be cut in 2024 subject to inflation reducing further**
- **The UK officially went into recession in the second half of last year but the magnitude of decline was mild**
- **Corporate bond spreads continued on their downward trajectory over the quarter for both investment grade and high yield bonds**
- **UK DB pension scheme funding improved thanks to yield rises in January combined with growth asset performance throughout the quarter**

Faye Clark
Head of Manager Research

Click to watch
Faye's April update

Global equities are off to a flyer in 2024 as tech stocks lead the way

Global equities posted their best first quarter since 2019 ignited by an Artificial Intelligence (AI) boom and the continued resilience of the US economy despite stubbornly high inflation.

Computer chip designer Nvidia has contributed around 20% of the growth in global market capitalisation over the first quarter and it was their late February earnings report and forecast that triggered a rally for technology stocks. The tech rally broadened out across the global equity market as the continued resilience of the US economy to higher borrowing costs was cause for infectious optimism around the globe that a soft landing would be executed to finally bring inflation under control.

However, inflation in the US remained higher than was hoped for in January and February. This led investors to pare back expectations of the magnitude of interest rate cuts that the Federal Reserve (Fed) would introduce in 2024. The market is now aligned with the Fed's expectation of three quarter-point rate cuts this year after the Fed chose to hold the federal funds rate at 5.25% - 5.50% for the fifth consecutive meeting in March. Interest rate swap markets had previously been much more optimistic over the pace at which borrowing costs might start to come down.

The Bank of England mirrored the Fed by holding the bank rate for a fifth consecutive meeting at 5.25%. For the first time since September 2021 none of the Monetary Policy Committee members voted for an increase in the bank rate as the 12-month Consumer Prices Index fell sharply from 4.0% to 3.4% over February. Governor Andrew Bailey signposted that markets were moving in the right direction, but that inflation would need to continue to fall back towards the long-term target of 2% before cuts would be initiated.

In February it was revealed that the UK experienced a technical recession with two quarters of negative GDP growth of -0.1% in Q3 and -0.3% in Q4 2023. However not all recessions are equal and this one is mild compared to the Global Financial Crisis which saw 5 consecutive quarterly contractions totalling -6.5%.

In contrast to recent years, where central bank action has been largely homogenous, different regions now find themselves moving rates in different directions. Major Western central banks are getting closer to interest rate cuts, with the Swiss National Bank the first to actually do it with a 0.25% cut to 1.5% with Swiss inflation having been below 2% since mid-2023. Meanwhile, the Bank of Japan (BOJ) has pushed borrowing costs in the opposite direction. For the first time in 17 years, the BOJ raised interest rates – which were previously negative – to a range of 0.0%-0.1% in March. Japan was the last remaining country in the world with negative interest rates.

UK equities and other major European indices outperformed global equities in March as they caught up with the surge in global equities from AI-driven gains in the US. Emerging market equities recovered from a tough January to post a strong recovery over February and March driven to a large extent by state-driven purchases of Chinese equities as China's Securities Regulatory Commission continues to pursue its objective of revitalising interest in its waning domestic stock market.

In bond markets, UK corporate bonds spreads have tightened over the past 12 months to their lowest levels in 2 years. Falling spreads are positive for performance and UK corporates managed to deliver modest positive returns despite rising gilt yields in the first quarter. Global high yield bond spreads have also compressed substantially in recent months and sit at the bottom of a trading range that has persisted since the Global Financial Crisis. Corporate borrowers have rushed to issue debt in early 2024 in a bid to avoid potential volatility later in the year during the final stages of the US Presidential election.

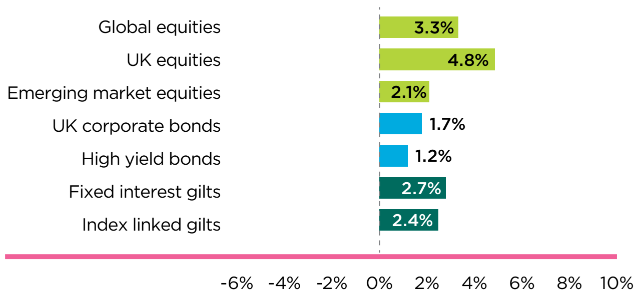
Aggregate UK DB pension scheme funding benefitted from falling liabilities resulting from the rise in yields witnessed in January. Yield rises in February were subsequently offset by falls in March. The impact of liability matching assets falling in value was broadly offset by consistently strong returns from equity and credit assets. As a consequence, funding on a low risk basis rose significantly in the first quarter of 2024.

The tech rally broadened out across the global equity market as the continued resilience of the US economy was cause for infectious optimism.

Market returns

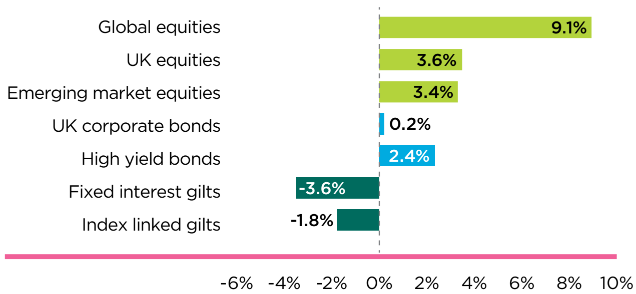
Growth assets performed strongly in the first quarter whilst gilts posted negative returns

1 month to 31 March 2023



Source: Refinitiv

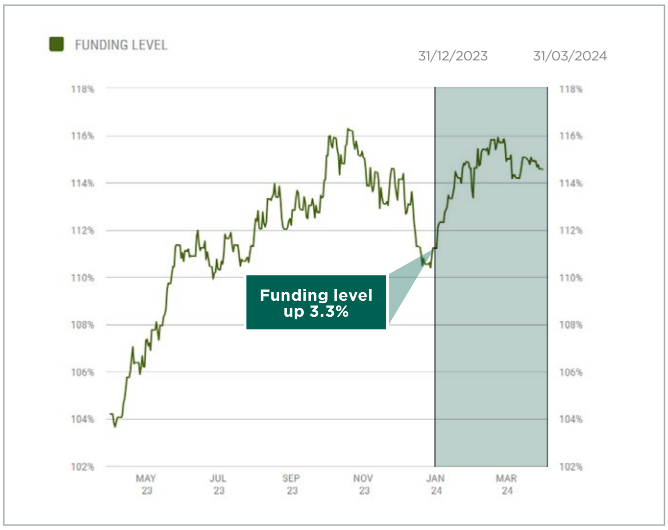
3 months to 31 March 2023



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 70% 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 Faye Clark:

Simeon Willis
Chief Investment Officer

e simeon.willis@xpsgroup.com

Faye Clark
Head of Manager Research

e faye.clark@xpsgroup.com

Alternatively, please speak to your usual XPS contact.

XPS Investment