April 2021

XPS Investment News

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

Quarter in brief

- Global equities return positively, driven by continued Covid-19 vaccine rollout and further stimulus measures
- Global government bonds sell off sharply upon mounting inflation concerns, also impacting investment grade and high yield bonds
- Bitcoin's price rises materially

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Head of Investment
– Bristol

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Sophie's April update

Optimism continues to drive markets

Global equity markets held up well over the quarter, producing a positive return for the period, but gilt yields rose sharply to leave bond investors with heavy negative returns.

Developed countries globally spent much of the first quarter of 2021 under restrictive measures that had been re-imposed in response to the increasing spread of Covid-19 towards the end of last year. However, global equity markets largely focussed on the positive sentiment surrounding the global economy and performed well over the period.

This positive sentiment can be largely attributed to a two key drivers.

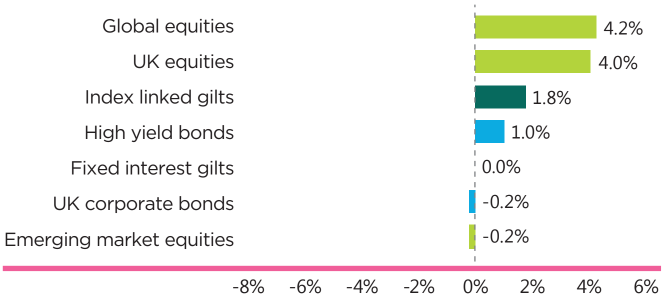
Firstly, the pace and scale of the Covid-19 vaccine rollout globally over the period, and the data that is supporting its effectiveness. More than 665 million vaccine doses have now been administered worldwide, equating to 8.7 doses for every 100 people. The UK and US have had great success which has significantly strengthened the economic prospects for these two large economies. Also, data from Israel, which has led the way with its vaccine programme, has shown the effectiveness of the jabs and the significant role they will play in getting the world back to normality. That-being-said, the rollout speed amongst countries has been uneven and the pace of Europe's rollout has lagged, largely due to supply problems and indecision around the safety of the AstraZeneca vaccine. As such, the continent is facing rising new cases and lengthened economic disruption, and this weighed on returns.

Secondly, governments and central banks announced continued, and significant further, stimulus support measures over the quarter. In the UK, the Chancellor used the Budget in March to announce and extend various measures aimed at supporting jobs, investment and the country's recovery from the pandemic, committing to spend another £65bn to tackle the effects of coronavirus, and the Bank of England's Monetary Policy Committee voted to keep the Bank Rate at its historic low of 0.1% and keep policy supportive. In the US, Joe Biden's $1.9tn coronavirus relief package was passed by the House of Representatives and the Fed Funds Rate target remains at its historic low of 0.0%-0.25%, combined with supportive policy where rate increases are now not expected until the end of 2023.

Market returns

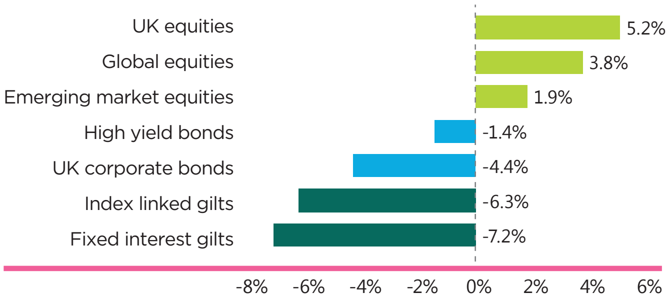
Asset returns ranked from highest to lowest

1 month to 31 March 2021



Source: Refinitiv

3 months to 31 March 2021



Source: Refinitiv

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The quarter's equity performance was predominantly driven by returns over March. Although equities made gains over the beginning of both January and February, they pulled back sharply at the back end of each month highlighting the fact that markets remain relatively volatile.

UK equities outperformed both global equities and emerging market equities.

There were other prominent stories – a large container ship ran aground and blocked ships passing through the Suez Canal in March, disrupting global trade flows, and a handful of large banks were hit with material losses due to the implosion of a family office, Archegos Capital, which they acted as a prime broker to. The quarter also saw some extraordinary equity price rises for certain individual stocks, after many retail investors focussed their efforts to actively buy some of the markets most heavily shorted stocks. The stock that gathered the most attention was GameStop, a US retailer, which saw its price increase by over 1600% in January. Find out more about the suitability of strategies that short stocks for pension schemes **here**. Bitcoin's price has also risen significantly over the period and, as such, grabbed news headlines. XPS looked into whether cryptocurrency has a place in a pension scheme portfolio **here**.

Economic data released towards the end of the period for the UK was significantly better than economists expected, suggesting that households and companies have been more resilient to the latest lockdown. The unemployment rate unexpectedly fell in February and the Purchasing Managers' Index and business surveys showed a strong uptick in activity in March.

Global government bonds sold off materially during the second half of February and gilt yields have remained elevated since. The yield on the 10-year gilt increased from 0.2% at the beginning of the quarter to 0.9% at the end of March. These substantial yield increases were widely attributed to the same positive sentiment that drove equity prices. In addition, investors are also concerned about mounting inflationary pressures that erodes the real return on fixed income bonds.

Long-term UK inflation expectations rose modestly but not enough to offset the increase in UK real yields, meaning that most pension schemes will have benefitted, by some degree, from the gilt yield rises through a material fall in liability values.

Sterling investment grade corporate bonds returned negatively over the period due to the material government bond yield increases, although credit spreads themselves remained relatively flat. High yield bonds, which are typically shorter maturity than investment grade corporate bonds, were more resilient to these yield rises but still returned negatively over the period despite high yield credit spreads reducing slightly over the period.

The funding level of a typical pension scheme would have increased over the quarter, owing to falls in liability values due to the government bond yield rises and comparatively good performance of risk bearing assets over the period.

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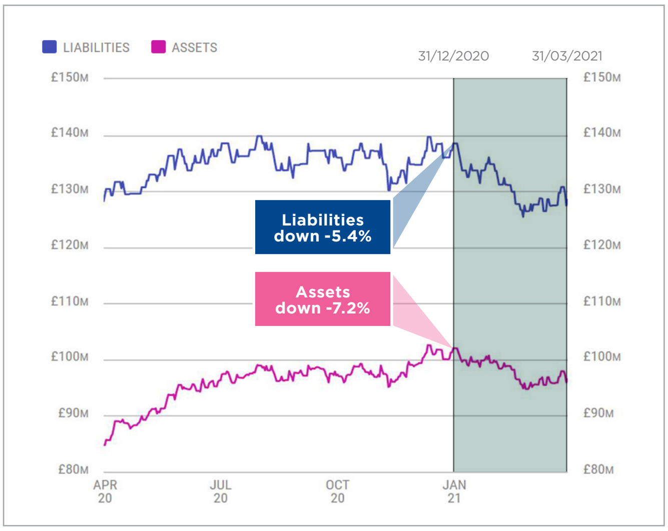
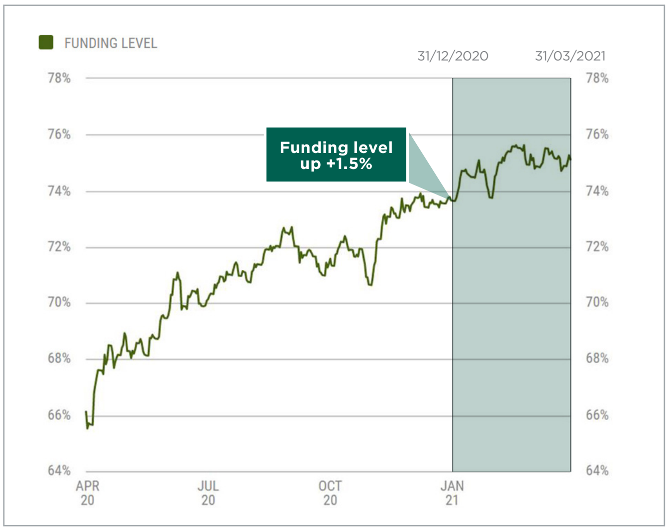
Asset and liability progression for typical scheme



Source: XPS Radar

Funding level progression for typical scheme



Source: XPS Radar

The typical scheme used has an assumed asset allocation of 24% equities, 33.8% corporate bonds, 12.6% multi-asset, 5% property and 24.6% in liability driven investment (LDI) with the LDI overlay providing a 60% hedge on inflation and interest rates. This example scheme was 80% funded in 2015.

XPS Investment asset class views

Asset class	Favourable	Neutral	Unfavourable	Movement
Developed equities		●		↑
Emerging market equities		●		
Investment grade corporate bonds		●		
High yield bonds		●		
Private debt	●			↑
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 Sophie Tennison:

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