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PRUDENTIAL
Staff Pension Scheme
Defined Contribution Section

# Market commentary from the DC Section Investment Consultant

April 2024

Your journey

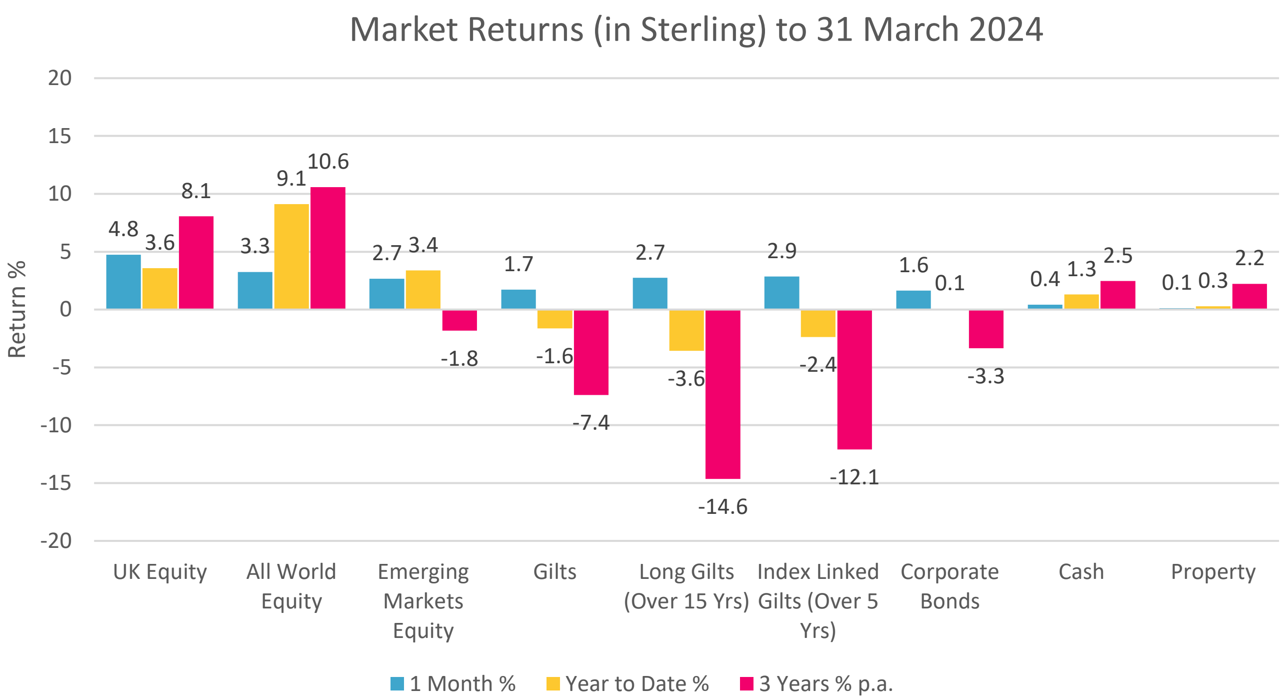
# Investment Markets and PSPS Funds Update – April 2024

## Introduction

This paper is addressed to the Trustee of the Prudential Staff Pension Scheme ("Scheme") DC Section and provides a regular update on the performance of PSPS funds and investment markets.

This paper should not be released or otherwise disclosed to a third party except as required by law or with our prior written consent, in which case it should be released in its entirety. This paper may be shared with DC Section members of the Scheme on a non-reliance basis. We accept no liability to any third party unless we have expressly accepted such liability in writing.

## Performance of Investment markets




Note: Property one month in arears. Source: Datastream

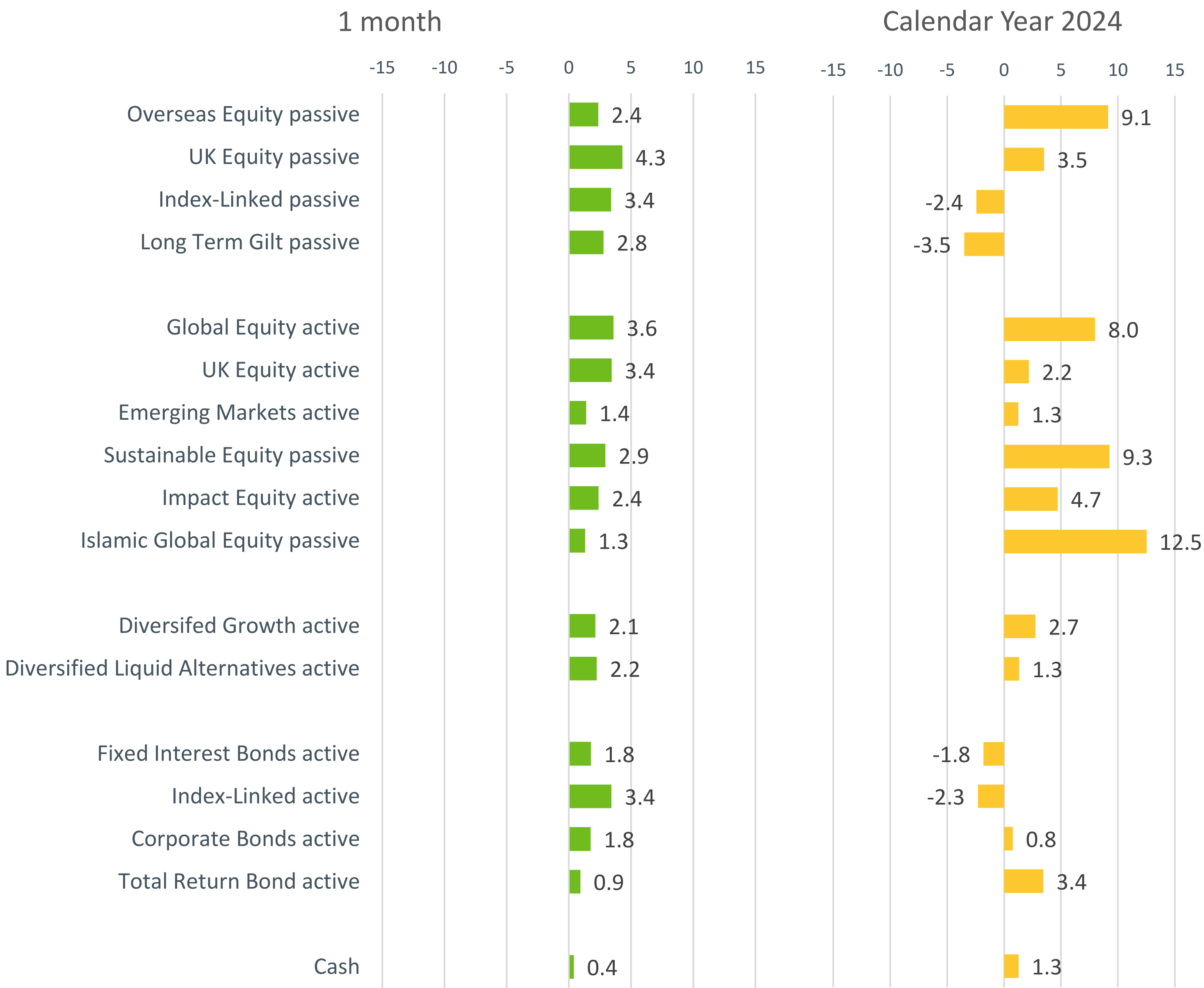
Indices: FTSE All Share, FTSE All World £, FTSE All Emerging £, FTSE British Govt Over 15Y, FTSE British Govt Index Linked Over 5Y, iBoxx Sterling Non-Gilts, SONIA, MSCI UK Monthly property

## Quarter 1 2024 highlights

- Backward-looking GDP data releases showed the US economy was more resilient at the end of 2023 than previously thought. In contrast, growth was much weaker in the UK, eurozone, and Japan.
- That said, flash composite purchasing managers' indices (PMIs) suggest the worst may be over in Europe, as UK output expanded for the fifth consecutive month in March and the eurozone economy stabilised.
- At a global level, survey data suggest growth improved at the start of 2024, as the JP Morgan Global Composite PMI rose to an eight-month high in February.
- US inflation came in above expectations in January and February.
- Markets dramatically scaled back their expectations of the timing and size of interest rate cuts in 2024, due to stronger US growth than expected, improving global growth momentum and signs the downtrend in inflation is slowing.

- But economic optimism and AI enthusiasm offset expectations of slower rate cuts, as equites recorded their best first quarter in five years and credit spreads fell, despite significant rises in sovereign bond yields.
- Gold prices rose 7.2% amid lingering inflation concerns, heightened geopolitical tensions and strong demand among central banks and Chinese consumers. Oil prices rose 12.5% amid ongoing supply cuts and conflict in the Middle East.
- The trade-weighted US dollar rose around 2%, as the prospect of a sharp fall in interest rates faded. The Japanese yen fell almost 5% in trade-weighted terms.

The chart below shows the **estimated** performance (net of annual fees) of the PSPS funds for **February 2024** and for the calendar year 2024. Please note that these are estimates of fund performance and not official performance figures from the fund provider. Longer term historical performance can also be found in appendix 1.




Please note –One day price lag on underlying funds of Overseas Equity Passive Fund. Unit prices of underlying component funds sourced from Bloomberg or Fund manager websites.

### What is the impact on DC Section members?

- Returns were positive across all funds in March.
- Over the first three months of 2024, global equity funds have been strongest. With the exception of gilt and index-linked gilt funds, all funds have positive returns over this period.

### Lifestyle Returns

We show the estimated performance of the Multi-Asset Lifestyle in appendix 2 for periods to **31 December 2023.** In the lifestyle, the allocation of members' investments across certain PSPS funds is adjusted automatically depending on each member's period to targeted retirement date, moving from riskier to less risky assets as members approach retirement. Therefore, the returns for members will vary across age groups and between members with different period to retirement. In the appendix we show the estimated returns for 3 different types of members, based on their periods to retirement.

### Note on PSPS Cash Fund

The PSPS Cash Fund – active is a fund that is used in the lifestyle strategies (in the last few years prior to retirement age) and available as a self-select fund. It invests in cash and short dated instruments. Returns on cash funds are generally close to the Bank of England base rate. The base rate was cut to very low levels in the wake of the pandemic (it was 0.1% until 16 December 2021) but has risen to 5.25% since then.

### Note on Currency

For the PSPS funds which invest in non-UK assets, the funds bear currency risk (i.e. the effect of changes in the value of currencies and in particular the change in value of the currency in which the assets are invested relative to sterling). Therefore, the return from these funds is driven both by the change in valuation of the assets themselves and the translation of that value from the local currency to sterling.

### Market commentary – Quarterly Update to end March 2024

- Data released in the first quarter revealed that the US economy grew more quickly than previously envisaged, at an annualised quarterly pace of 3.4% in the final quarter of 2023, amid ongoing resilience in consumer spending. Meanwhile, European data showed the UK entered a technical recession, as GDP fell 0.3% in Q4 following a 0.1% contraction in Q3, and the eurozone economy flirted with one, after stagnating in Q4. The Japanese economy also narrowly escaped recession, eking out a 0.1% expansion in Q4, following a 0.8% contraction in Q3.
- But survey data suggested that the worst may already be over in Europe. Flash composite purchasing managers' indices (PMIs) indicate that UK output rose at a solid pace for the fifth consecutive month in March. Meanwhile, the eurozone economy stabilised as a modest recovery in service sector output gained momentum and the pace of decline in manufacturing output eased. Flash data also suggested that US business activity increased further at the end of Q1 amid a marked upturn in manufacturing production. March data added to evidence that global growth improved at the start of 2024, and also suggested the expansion is becoming more broad-based. A sustained increase in service sector activity was accompanied by signs that a nascent recovery in global manufacturing activity is gaining traction.
- Backward-looking GDP data and coincident survey data that point to an economy with much stronger momentum than previously anticipated, saw consensus forecasts for year-on-year US GDP growth in 2024 jump from 1.4% in January to 2.2% in March. At the same time, global growth forecasts for 2024 have been revised up to 2.4%. While European and UK forecasts are much weaker, the majority of economists think the worst of the downturn in Europe is in the rear-view mirror and expect the majority of economies in the region to recover, albeit weakly, in 2024. Indeed, much better-than-expected survey data suggests the UK recession is already over and point to decent growth in Q1.

- Surveys suggest that better activity data has been accompanied by a reacceleration in customer prices in both the manufacturing and services sectors in recent months. Indeed, an unexpected rise in year-on-year US headline CPI inflation, to 3.2% year on year in February, further fuelled fears that the downtrend in inflation is slowing. Equivalent UK and eurozone measures, however, eased to 3.4% and 2.6%, respectively. The equivalent core measures, which exclude volatile energy and food prices, came in at 3.8%, 4.5%, and 3.1% in the US, UK and eurozone, respectively. Not only is UK core inflation still more than double the Bank of England's target, but elevated services and wage inflation, both running at 6.1% year on year, highlight persistence in underlying price pressures.
- Amid better-than-expected economic data and sticky inflation data, markets have scaled back expectations for the timing and number of interest rate cuts in 2024. At the end of Q1, markets expect two to three interest rate cuts from the major central banks in 2024 down from six to seven at the start of the year. The recent shift brings markets more closely in line with the major central banks' more cautious messaging as to the likely timing and extent of interest-rate cuts. In March, the Bank of Japan raised rates for the first time in 17 years, from minus 0.1% pa to a still accommodative 0.0–0.1% pa. Inflation has exceeded the Bank of Japan's target for 22 months and data from annual wage negotiations bolstered the case. The Bank of Japan also stopped yield-curve control and exchange-traded fund purchases.
- Amid expectations that interest rates might be cut less than previously anticipated, sovereign bond yields rose sharply in quarter one. UK and US 10-year bond yields rose 0.4% pa and 0.3% pa to 3.9% pa and 4.2% pa, respectively, while equivalent German yields rose 0.3% pa to 2.3% pa. Despite the Bank of Japan raising rates and ending yield curve control, Japanese yields rose by a modest 0.1% pa, to 0.7% pa. This perhaps owes to expectations monetary policy will remain accommodative, regardless, and the Bank of Japan suggesting they will still act to prevent a disorderly rise in yields.
- UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose 0.2% pa, to 3.6% pa, as nominal yields rose more than real yields. Equivalent US implied inflation rose by the same amount, to 2.4% pa, while German implied inflation rose 0.1% pa, to 2.1% pa.
- Credit spreads fell sharply across regions and credit ratings over Q1, in part reflecting the improved outlook, but strong yield-driven demand from institutional investors also likely played a part. Sterling and European investment-grade credit spreads fell 0.2% pa to 1.1% pa, while equivalent US spreads fell 0.1% to 0.9% pa. Speculative grade spreads fell more, with European spreads narrowing 0.4% pa to 3.5% pa and equivalent US spreads coming down 0.2% pa to 3.1% pa. Despite spread tightening, sterling investment-grade total returns were broadly flat, given the rise in underlying sovereign bond yields. Speculative-grade credit markets outperformed, with US high yield producing a total return of 1.5%. This reflects both greater spread tightening and lower interest-rate sensitivity, given the shorter duration, in speculative-grade markets.
- Global equities recorded their best first quarter in five years, with the FTSE All World Total Return Index rising 9.5% in local-currency terms, as optimism about the US economy and AI-enthusiasm offset expectations of slower rate cuts. Technology stocks notably outperformed as massive earnings-beats by some high-profile US technology companies benefitted the sector more broadly. Also outperforming, but to a much lesser extent, were cyclical sectors, such as financials, energy and industrials, in that order. Basic materials were the worst-performing sector, which some commentators suggest is linked to concerns about slowing demand for, and the over-supply of, electric vehicles. This has led to falls in the prices of some industrial metals, such as lithium. Outside basic materials, the main underperformers were defensive sectors, such as consumer staples, utilities, telecoms and healthcare (in that order) which tend to underperform in strong positive markets.
- Japan strongly outperformed over the quarter. Further yen weakness lent support to the export-heavy index, and rising prices for domestic chip-related stocks and growing enthusiasm around corporate governance

reforms led Japanese equities 18.7% higher. Given its large, above-average exposure to the technology sector, US equities outperformed, but to a lesser extent. While European equities continued to lag the US and Japan, they marginally outperformed over the quarter.

- Emerging markets underperformed as investors remained concerned about China's growth prospects amid ongoing property market weakness and disappointment with policy stimulus unveiled so far. The UK was the worst-performing region over the first quarter. Having very little exposure to the outperforming technology sector, and above-average exposure to consumer staples and basic materials, weighed on performance, but economic weakness contributed to UK-listed companies underperforming global peers across almost all sectors.
- Gold prices rose 7.2% amid lingering inflation concerns, heightened geopolitical tensions, and strong demand among central banks and Chinese consumers. Oil prices rose 12.5% amid ongoing supply cuts and conflict in the Middle East. The trade-weighted US dollar rose around 2%, as the prospect of a sharp fall in interest rates faded. The Japanese yen fell almost 5% in trade-weighted terms. While the Bank of Japan exited negative interest rates in March, monetary policy remains comparatively accommodative, and markets continue to bet on a wide interest-rate differential between Japan and its major developed market peers.
- The MSCI UK Monthly Property Total Return Index rose 0.3% in the first two months of 2024, despite a 0.7% decline in capital values, in aggregate. The 12-month total return to end-February was 0.7%, as income offset a 4.9% fall in capital values. Over 12 months, capital values fell most steeply in the office sector, declining 16.5%, compared with a 5.1% fall in the retail values and a 1.5% rise in industrial values. While values continue to fall in the office sector month on month, the pace of decline in the MSCI UK Monthly Property Capital Value Index, which is now almost 26% below its June 2022 peak, has slowed in recent months.

Prepared by: -

| | |
|---|---|
| Mark Jaffray | David Millar |
| Partner | DC Investment Consultant |

April 2024

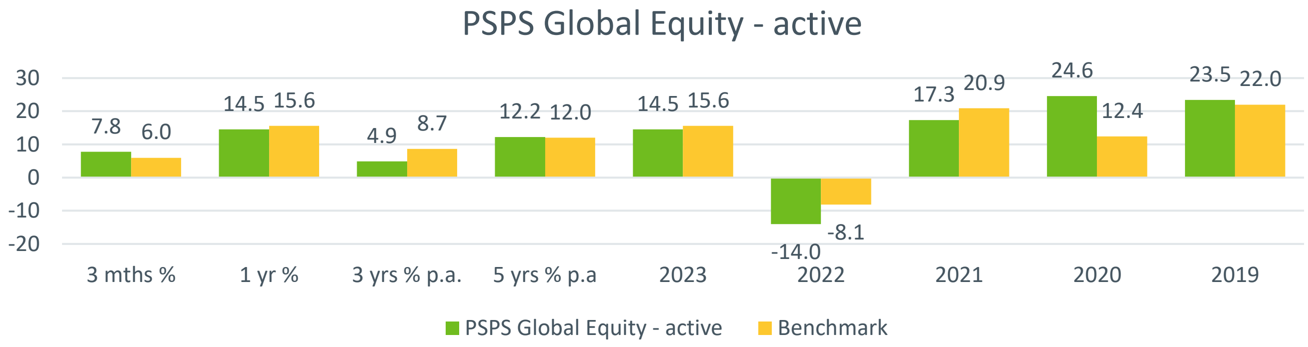
For and on behalf of Hymans Robertson LLP

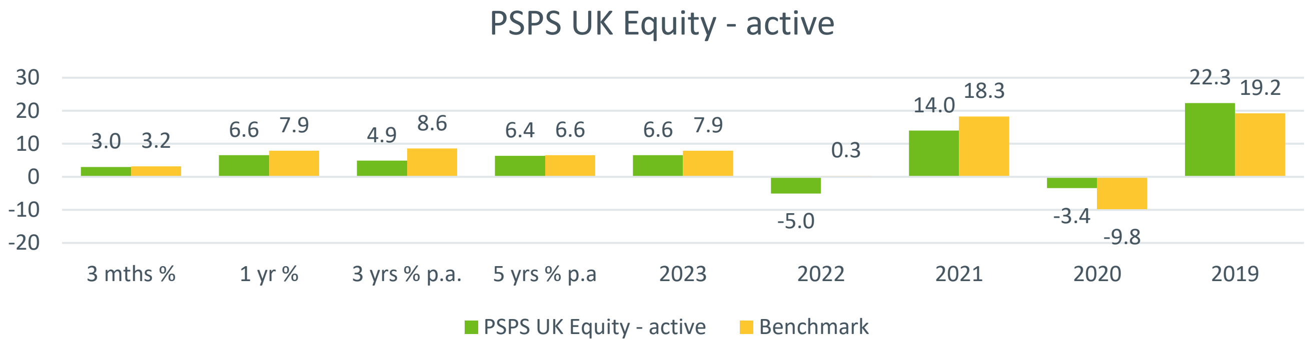
**GENERAL RISK WARNING**

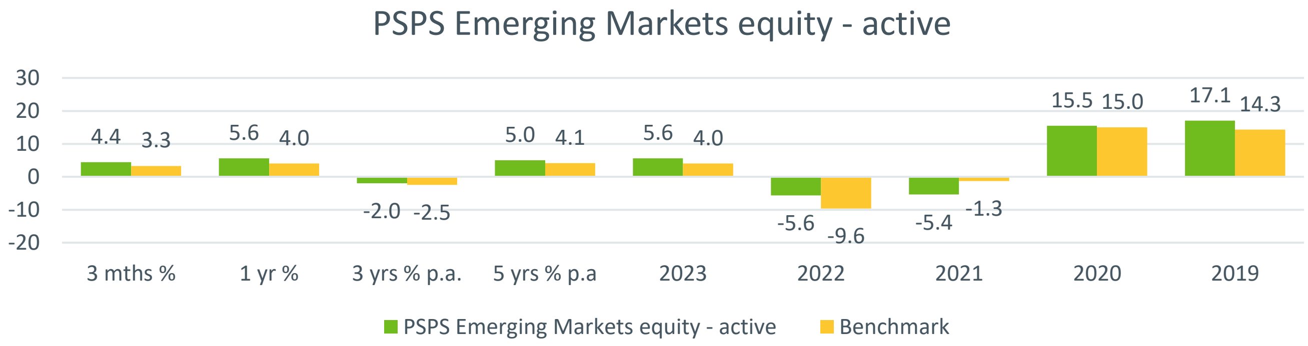
Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.
Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

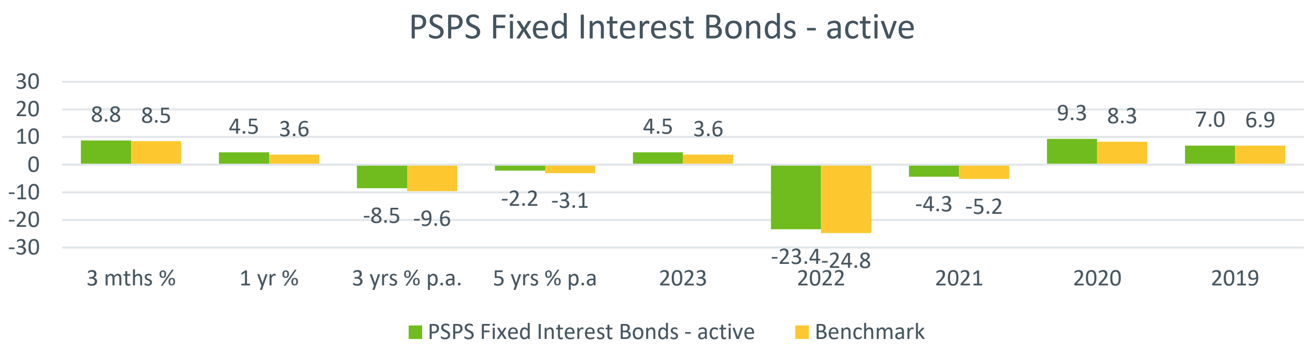
# Appendix 1 – Performance of PSPS Funds (to 31/12/23)

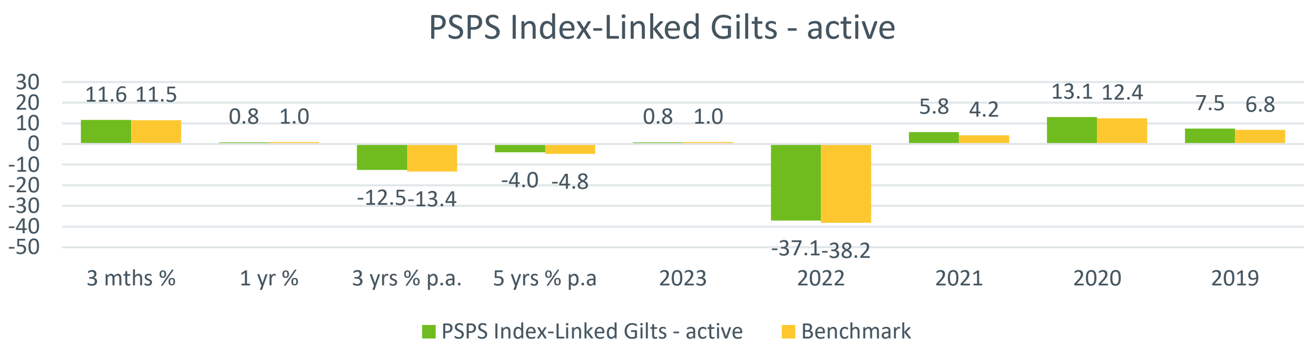
The charts below summarise the performance (gross) of the PSPS funds and their benchmarks showing historic calendar years and the current calendar year to latest available quarter end date (updated quarterly). **Official performance data from fund provider shown below is to end December 2023.** (Source Prudential Assurance Company Limited).

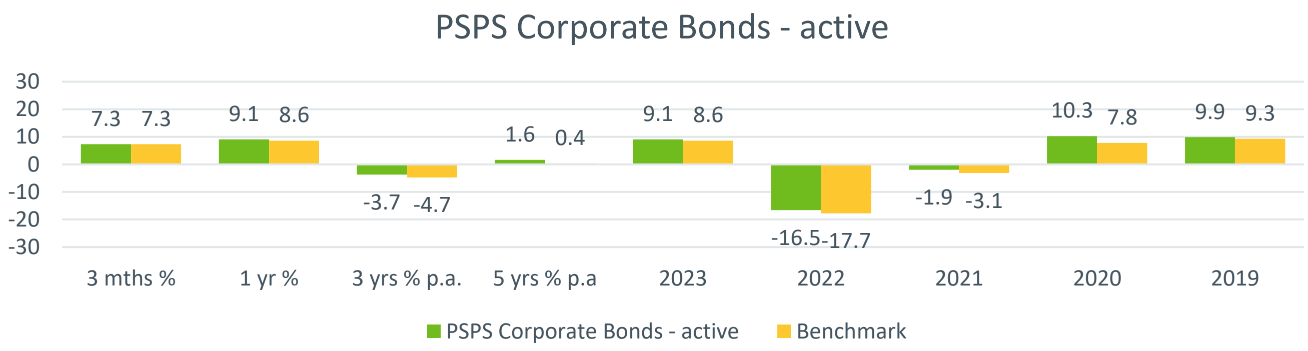



PSPS Fixed Interest Bonds - active
30
20
10
0
-10
-20
-30
8.8 8.5
4.5 3.6
-8.5 -9.6
-2.2 -3.1
4.5 3.6
-23.4 -24.8
-4.3 -5.2
9.3 8.3
7.0 6.9
3 mths %
1 yr %
3 yrs % p.a.
5 yrs % p.a
2023
2022
2021
2020
2019
PSPS Fixed Interest Bonds - active
Benchmark


PSPS Index-Linked Gilts - active
30
20
10
0
-10
-20
-30
-40
-50
11.6 11.5
0.8 1.0
-12.5 -13.4
-4.0 -4.8
0.8 1.0
-37.1 -38.2
5.8 4.2
13.1 12.4
7.5 6.8
3 mths %
1 yr %
3 yrs % p.a.
5 yrs % p.a
2023
2022
2021
2020
2019
PSPS Index-Linked Gilts - active
Benchmark


PSPS Corporate Bonds - active
30
20
10
0
-10
-20
-30
7.3 7.3
9.1 8.6
-3.7 -4.7
1.6 0.4
9.1 8.6
-16.5 -17.7
-1.9 -3.1
10.3 7.8
9.9 9.3
3 mths %
1 yr %
3 yrs % p.a.
5 yrs % p.a
2023
2022
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2020
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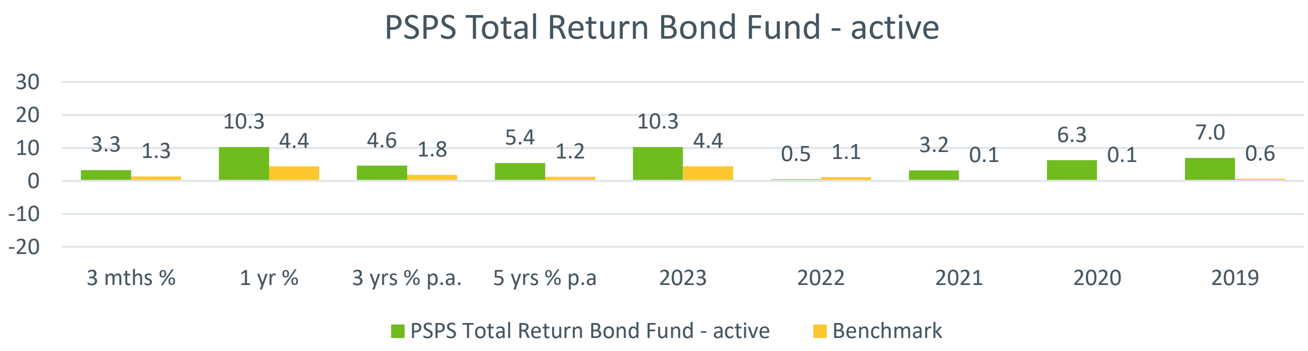
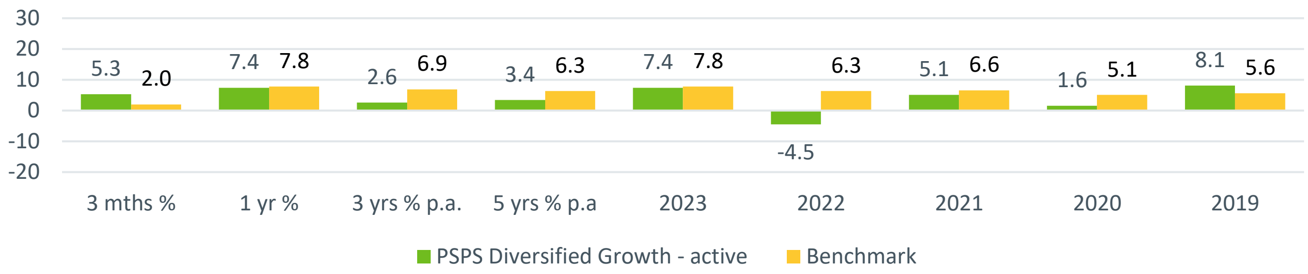
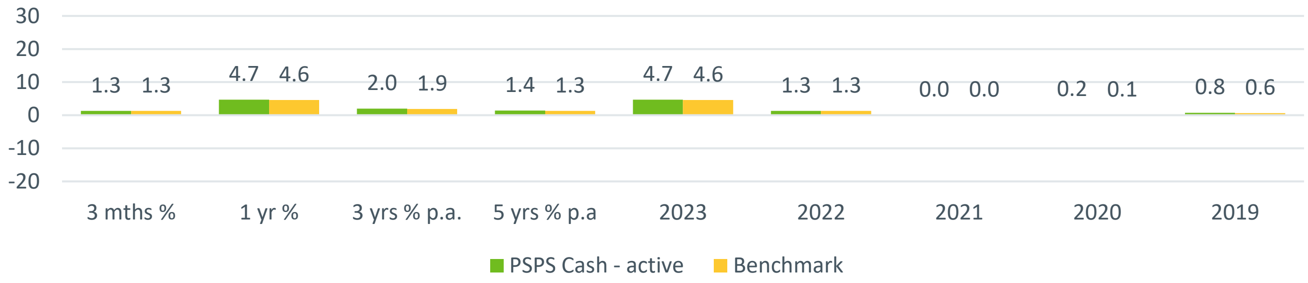
PSPS Corporate Bonds - active
Benchmark


PSPS Total Return Bond Fund - active
30
20
10
0
-10
-20
3.3 1.3
10.3 4.4
4.6 1.8
5.4 1.2
10.3 4.4
0.5 1.1
3.2 0.1
6.3 0.1
7.0 0.6
3 mths %
1 yr %
3 yrs % p.a.
5 yrs % p.a
2023
2022
2021
2020
2019
PSPS Total Return Bond Fund - active
Benchmark

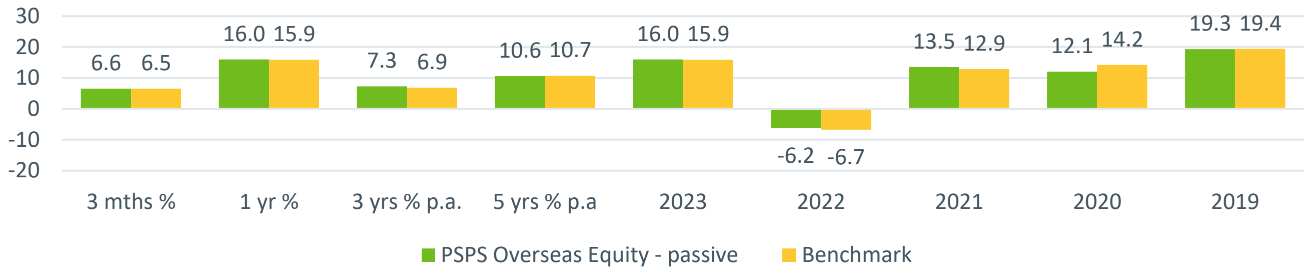
## PSPS Diversified Growth - active



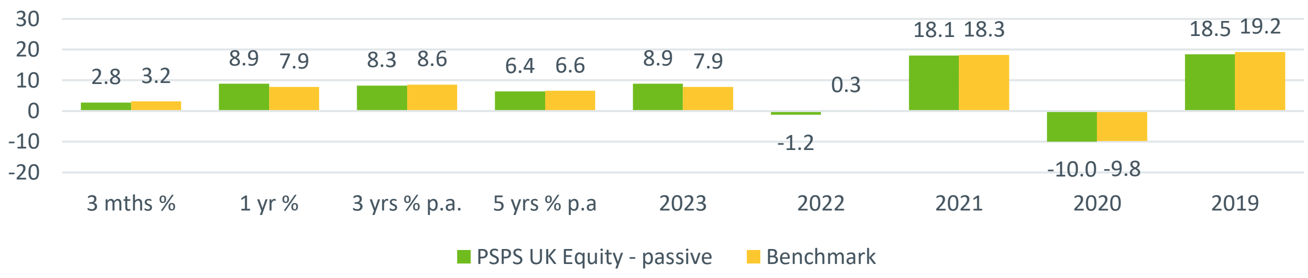

## PSPS Cash - active

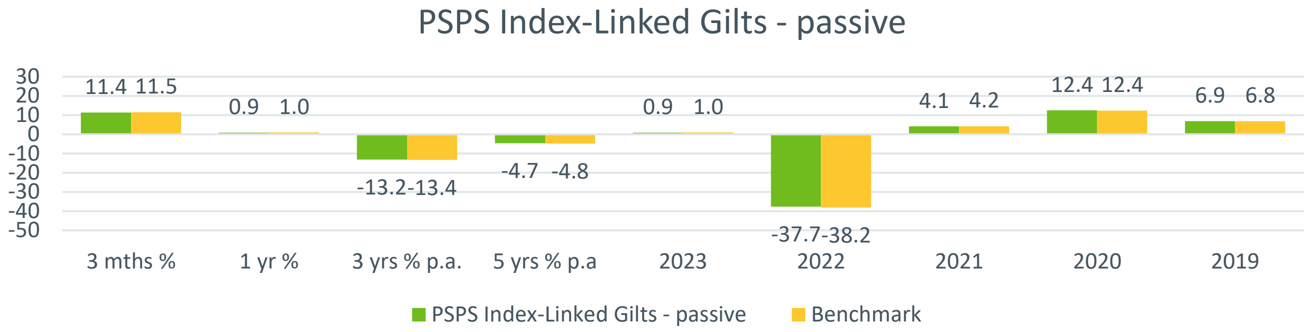


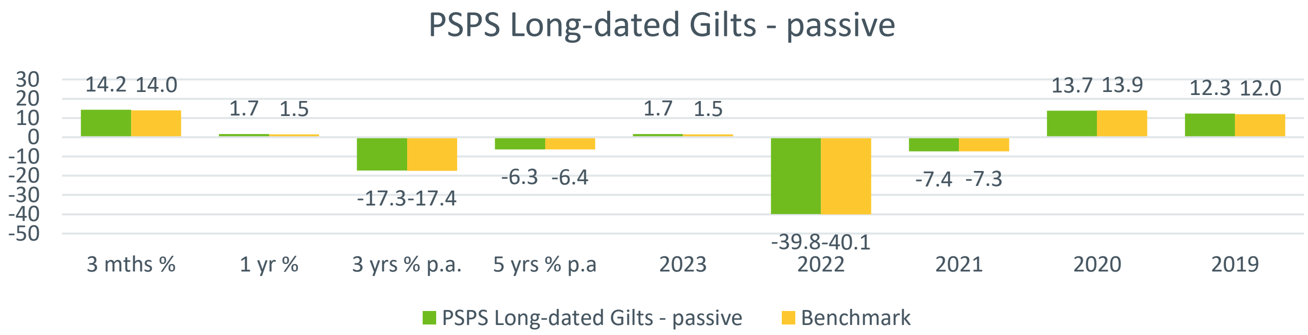

## PSPS Overseas Equity - passive

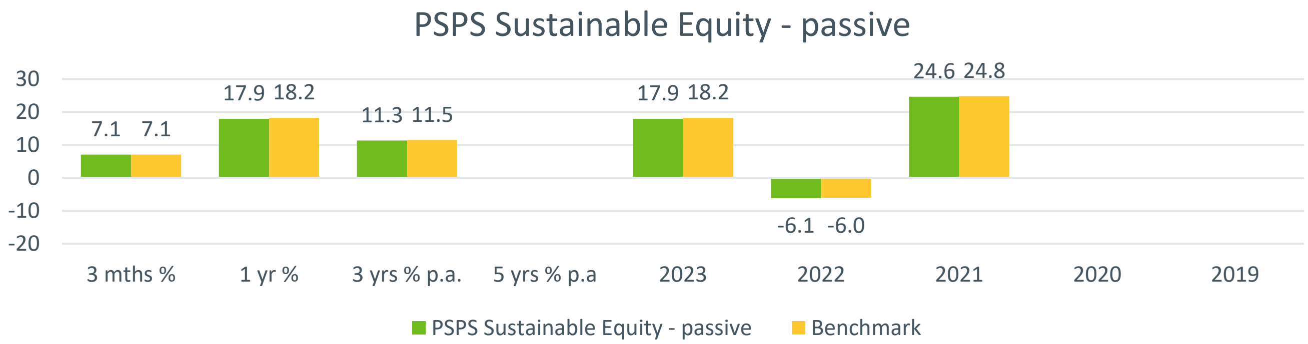



## PSPS UK Equity - passive





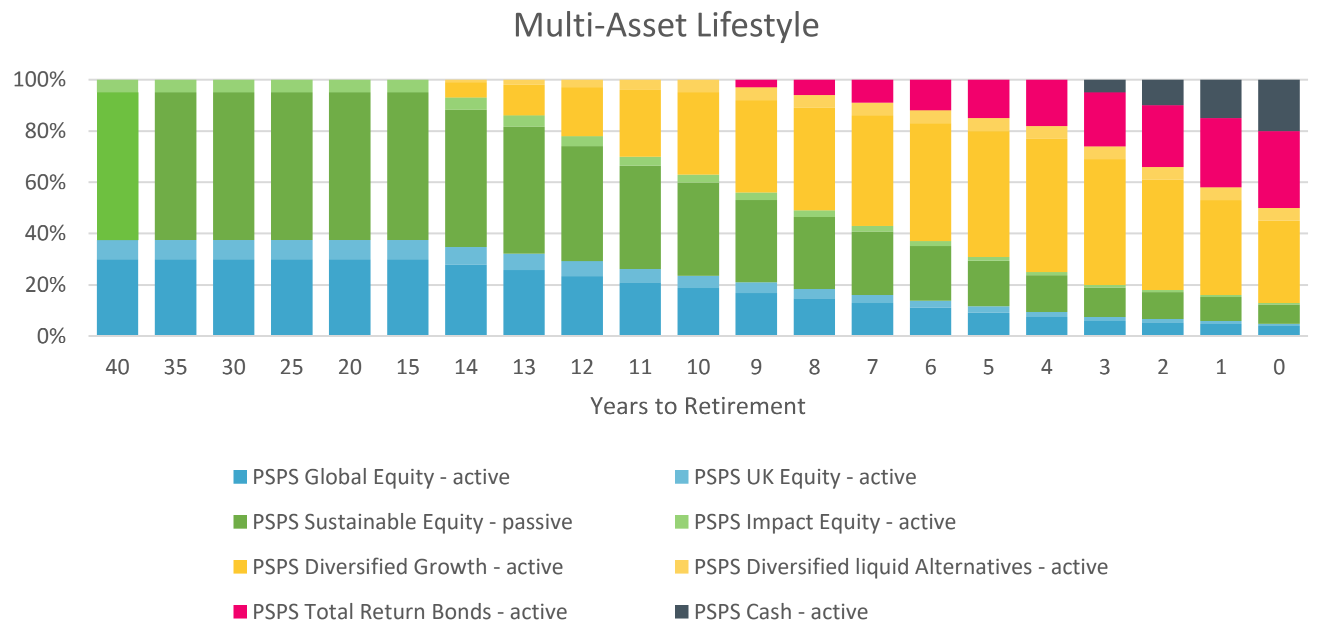




PSPS Sustainable Equity - passive Fund launched 10th January 2020 (formerly called PSPS Responsible Investment Equity -passive Fund)

# Appendix 2 - Lifestyle Performance

The Multi-Asset Lifestyle strategy automatically adjusts members' investments across certain PSPS funds based on their periods to targeted retirement date as illustrated below, moving from riskier to less risk assets as retirement approaches.




Because the allocation to certain funds varies from member to member based on the period to retirement, returns for individual members will vary depending on their period to retirement. Therefore it is not possible to state a single figure for the lifestyle return but instead we have estimated three returns that are representative of different types of members based on their period to retirement.

We have selected a member with 30 years to retirement whose returns will reflect members earlier in their career and is a reasonable assumption of the return for any member who is over 15 years from retirement. We then also show the returns for members 10 and 3 years from retirement who will have begun the process of moving from riskier to less risk assets.

**Estimated Performance for periods to 31 December 2023**

| Member - Years to Target Retirement Age | 3 Months % | 12 Months % | 3 Years % p.a. | 5 Years % p.a. |
|---|---|---|---|---|
| **30 Years** | 7.2 | 15.2 | 6.5 | 9.8 |
| **10 Years** | 6.5 | 11.7 | 4.7 | 6.5 |
| **3 Years** | 5.0 | 9.4 | 3.7 | 5.1 |

Performance based upon Lifestyle and years to retirement. Asset allocations will vary in line with the lifestyle chart shown (above). Actual performance for individual members will vary. Figures are illustrative and are not actual performance experienced.

Performance has been estimated for a member at certain periods to retirement (as at date to which performance is estimated, i.e. quarter end date referred to in table above) based on the approximate returns achieved historically on a quarter-by-quarter basis through being invested in the current lifestyle strategy (introduced in May 2023 and shown in the chart, above) and its predecessor lifestyles.