



PRUDENTIAL

Staff Pension Scheme

Defined Contribution Section

Market commentary from the DC Section Investment Consultant



July 2024

Your journey

Investment Markets and PSPS Funds Update – July 2024

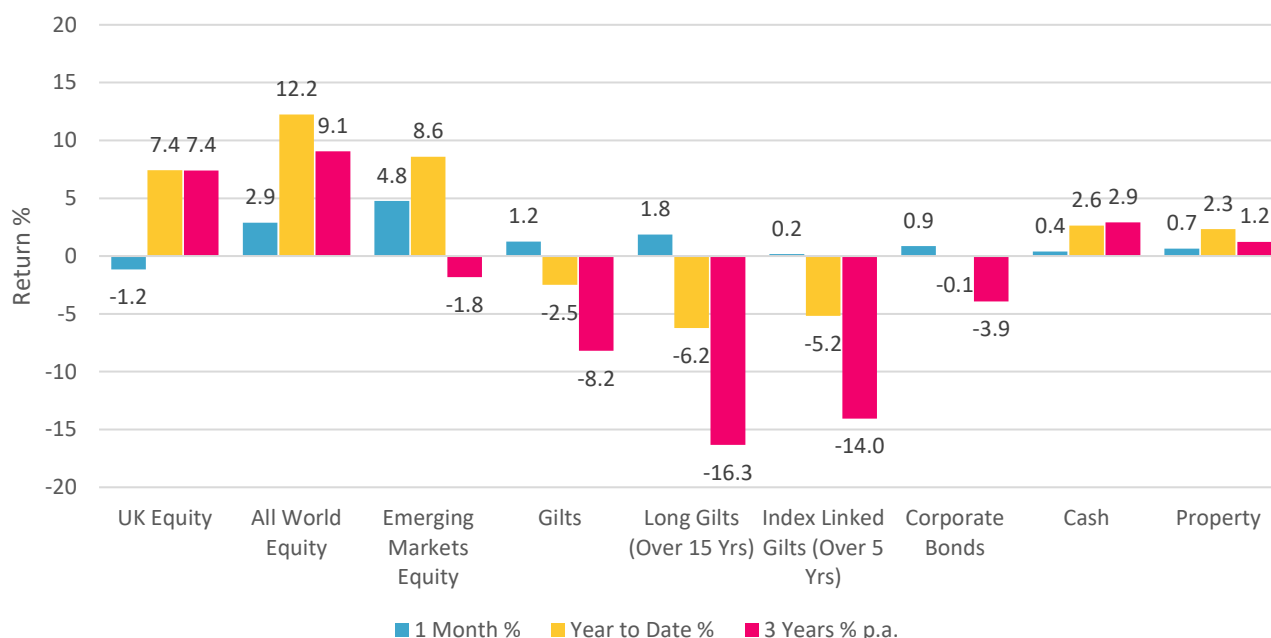
Introduction

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.

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Performance of Investment markets

Market Returns (in Sterling) to 30 June 2024



Source: Datastream

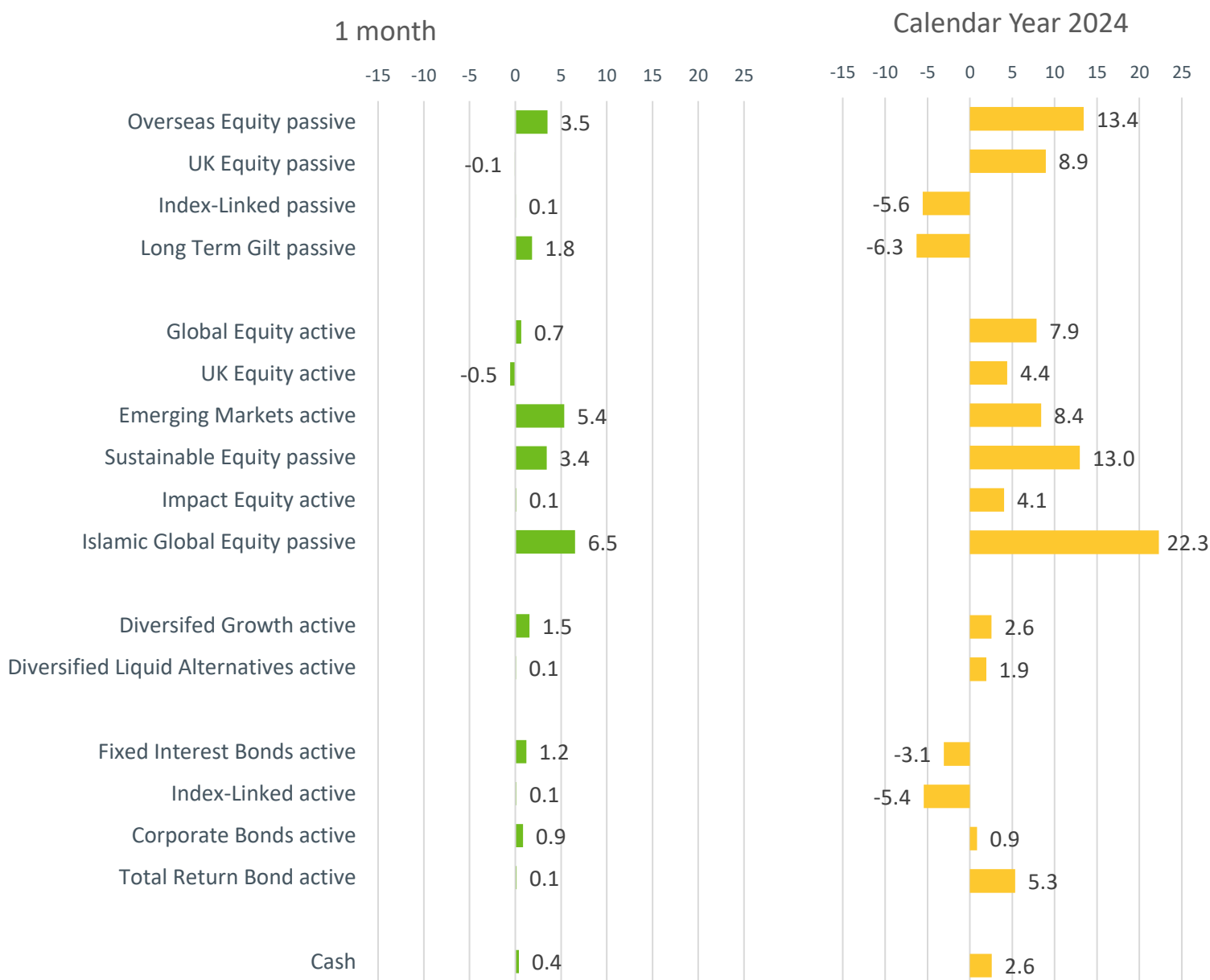
Indices: FTSE All Share, FTSE All World £, FTSE All Emerging £, FTSE British Govt Over 15Y, FTSE British Govt Index Linked Over 5Y, iBoxx Sterling Non-Gilts, SONIA, MSCI UK Monthly property

Quarter 2 2024 highlights

- Data released in Q2 showed US Q1 GDP growth slowed more than expected. But the data points to still-decent domestic demand, while the eurozone and UK officially exited technical recessions in Q1.
- US composite purchasing managers' indices (PMIs) exceeded expectations in May, and June's data point to robust growth in both services and manufacturing at the end of Q2.
- Outside the US, the JP Morgan Global composite PMI suggests global growth slowed at the end of Q2 across sectors and regions, including the eurozone and UK, but is still consistent with a solid pace of expansion.
- Crucially, the JP Morgan Global manufacturing PMI held close to a two-and-a-half year high in June, signalling improving operating conditions in the sector for the past five months in a row.

- While it remains stubbornly above target, at 3.3%, US headline CPI inflation edged lower in April and May. Equivalent UK inflation returned to the Bank of England's (BoE) target for the first time in almost three years, while it rose unexpectedly in the eurozone, to 2.6%.
- Despite the recent inflation setback, the European Central Bank (ECB) reduced rates by 0.25% pa, to 3.75% pa in June. Amid still-elevated core and services inflation, the US Federal Reserve (Fed) and BoE held rates steady, and markets continue to expect fewer rate cuts in 2024 than they did at the start of the year.
- Sovereign bond yields rose on the back of decent growth and sticky inflation outturns, while credit spreads were little changed over Q2. Resilient growth and ongoing optimism for all things AI saw equities post positive returns, with global growth stocks outperforming as US technology stocks surpassed earnings expectations.
- Commodities also performed well. Gold reached all-time highs and industrial metal prices rose as Chinese economic data improved and surveys pointed to a nascent recovery in global manufacturing activity.
- The trade-weighted US dollar rose 2.2% as markets further reduced their rate-cut expectations in 2024. The Japanese yen fell a further 4.5% in Q2 as markets continued to bet on a wide interest-rate differential between Japan and its major advanced economy peers.

The chart below shows the **estimated** performance (net of annual fees) of the PSPS funds for **June 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 most funds in June.
- Over the first six months of 2024, 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 March 2024**. 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 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 June 2024

- Backward-looking data confirmed that the US economy slowed more than expected in Q1 to an annualised quarterly pace of 1.4%. While this marks a sharp pullback from the blistering 3.4% pace set in the last quarter of 2023, the slowdown was mainly due to volatile business inventories and higher imports, with the economy still exhibiting decent, if slowing, domestic demand. Quarter-on-quarter eurozone and UK GDP increased by 0.3% and 0.7%, respectively, in Q1. The expansion was larger than expected in both regions and means both economies officially exited technical recessions in Q1. The Q2 UK GDP data release marked the fastest quarterly pace of growth since 2021, largely driven by services growth. In Asia, China's 1.6% quarter-on-quarter expansion was larger than most economists expected, while Japan's economy contracted by a larger-than-expected 0.5% quarter on quarter.
- After April's downside surprise, US composite PMI data exceeded expectations in May and June, indicating that activity expanded robustly at the end of Q2. Outside the US, the Global Composite PMI, which aggregates global activity across both the manufacturing and service sectors, suggested the global growth upturn had eased as expansions in output and new orders slowed. While the weaker pace of expansion was broad-based across sectors and regions, including the UK and eurozone, the index is still consistent with a solid pace of expansion in global GDP. A further increase in the global employment PMI suggests the underlying fundamentals are resilient. Crucially, the JP Morgan Global manufacturing PMI held close to a two-and-a-half year high in June, signalling better operating conditions in the sector for the past five months in a row.
- At a global level, composite input and selling price PMIs are generally consistent with slowing, but still elevated, inflationary pressures. The UK composite PMI highlighted wage increases, higher shipping costs and rising raw material prices contributing to rising costs, suggesting that underlying inflation is likely to remain sticky for a little longer.
- UK year-on-year headline CPI slowed meaningfully, returning to the BoE's 2% target for the first time in almost three years in May. However, the decline was still slightly smaller than expected and is largely due to declines in energy prices and their interaction with the Ofgem energy price cap. Core CPI, which strips out volatile components like energy and food prices, also slowed but, at 3.5% year on year, highlights stubborn underlying inflation pressures. This is further illustrated by services CPI which, though slowing, remained at 5.7% year on year. US headline CPI fell to 3.3% in May after rising more than expected in March, while core CPI eased to 3.4%. Meanwhile, in the eurozone, headline and core CPI measures rose to 2.6% and 2.9%, respectively, in May as prices rebounded for energy and services. June's flash release suggests headline inflation eased to 2.5%, in line with forecasts, while core CPI remained unchanged at 2.9%, compared to forecasts of 2.8%.
- Despite the recent setback in inflation data, the ECB delivered a widely expected 0.25% pa reduction in its deposit facility interest rate, to 3.75% pa. However, the ECB raised its inflation outlook for 2024 and 2025, highlighting stickier-than-expected service-sector inflation, with markets expecting only one further cut in 2024. Amid still-elevated core and services inflation, the Fed and BoE held rates steady, at 5.5% pa and 5.25% pa respectively, and markets continue to expect fewer rate cuts in 2024 than they did at the start of the year.
- US and UK 10-year bond yields both rose 0.2% pa over the quarter, to 4.4% pa and 4.2% pa respectively, amid robust economic activity and signs of stubborn underlying inflation pressures. Despite the ECB's rate

cut, German sovereign bond yields also rose 0.2% pa to 2.5% pa, as the Governing Council struck a cautious tone on inflation and future rate cuts. French 10-year yields rose 0.5% pa, with the spread between French and German government bonds rising sharply. Investors feared that the prospect of dysfunctional politics, flagging growth, and a rising debt burden could dent France's attractiveness to foreign investors, who hold a large proportion of French debt.

- UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, eased 0.1% pa, to 3.6% pa. Equivalent US and German implied inflation also eased very slightly, to 2.3% pa and 2.0% pa, respectively.
- Amid resilient growth and ongoing optimism for all things AI, global equities delivered another quarter of positive returns, with the FTSE All World Total Return Index rising 3.5% (in local currency terms). US Q1 earnings comfortably beat expectations and stocks tied to AI continued to benefit from this trend. Despite cautious forward guidance, earnings releases were strong enough to prompt modest upgrades to full-year estimates for global earnings growth in both 2024 and 2025, which now sit at 10.0% and 13.4%, respectively. Technology was the clear outperforming sector, delivering a return of 13% (in local currency terms). Utilities were the only other, albeit modest, outperformer. All other sectors underperformed, with value-orientated sectors seeing the worst underperformance: industrials, basic materials, and consumer staples, all underperformed, in that order. Consumer discretionary also underperformed, as did the energy sector as oil prices fell. While healthcare, telecoms, and financials underperformed too, they did still manage to eke out positive returns.
- The Chinese authorities moved to support the real estate sector, which boosted Chinese equities, while the AI-exposed Taiwanese stock market also delivered strong returns. Combined, these developments have helped emerging market Asia Pacific ex-Japanese equities enjoy the strongest regional performance in Q2. Despite higher bond yields, strong Q1 earning releases and above-average technology exposure meant that US equities outperformed. An improving domestic economic environment also helped UK equities outperform modestly.
- Despite 'value' outperforming 'growth' stocks in Europe ex-UK and Japan, both regions underperformed, in that order. The snap election in France and subsequent market concerns about the possible outcome introduced significant volatility. The French equity market fell in June and detracted from the Europe ex-UK equities performance, which delivered a modest return of 0.8% (in local currency terms). Japan was the only other underperforming region. While yen weakness has typically been viewed as a positive for the export-heavy Japanese market, policymakers are growing concerned about the impact of yen weakness on the spending power of consumers and importers.
- The US trade-weighted dollar rose 2.2% over Q2 after recording a first negative month in May this year, following softer inflation and a modest increase in market-implied interest rates. The UK trade-weighted sterling rose 0.7% as the BoE held rates steady. Markets have come to expect only one 0.25% pa rate cut this year, while the equivalent euro measure softened a little as the ECB lowered rates. The Japanese trade-weighted yen fell a further 4.5%. Despite expectations that the Bank of Japan might increase interest rates, and efforts by policymakers to prop up the yen, monetary policy remains comparatively accommodative, and markets continue to bet on wide interest-rate differentials between Japan and its major developed-market peers.
- Gold rose 5.1%, reaching all-time nominal highs in May, supported by geopolitical tensions and central banks' buying activity. Industrials metal prices rose 8.6% following a sharp rise in copper prices, forecast supply shortages and increased demand. Oil prices fell 7.0% in May as traders questioned the durability of OPEC+ supply cuts and cast doubt on the strength of demand forecasts. But they recovered in June to end the quarter down 1.1%.

- The MSCI UK Property Total Return Index rose 1.0% through March to May as aggregate capital values increased month on month for the first time since 2022 in March this year; they rose modestly in both April and May. The 12-month return to end-May was 0.3%, as income more than offset a 5.3% fall in capital values. Capital values continued to fall in the office sector, down 15.6% year on year, though the pace of decline has eased in recent months. While retail capital values have plateaued in recent months, they are still 5.6% lower than their level 12 months ago. Industrial capital values, which have risen a very modest 0.2% over the last 12 months, have also stabilised. Aggregate annual nominal rental growth slowed to 3.6% pa in April and May, but real rental growth rose as year-on-year inflation fell more sharply. Structural demand continues to support rental growth in the industrial sector, but it remains much weaker in the office and retail sectors.

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July 2024

For and on behalf of Hymans Robertson LLP

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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.

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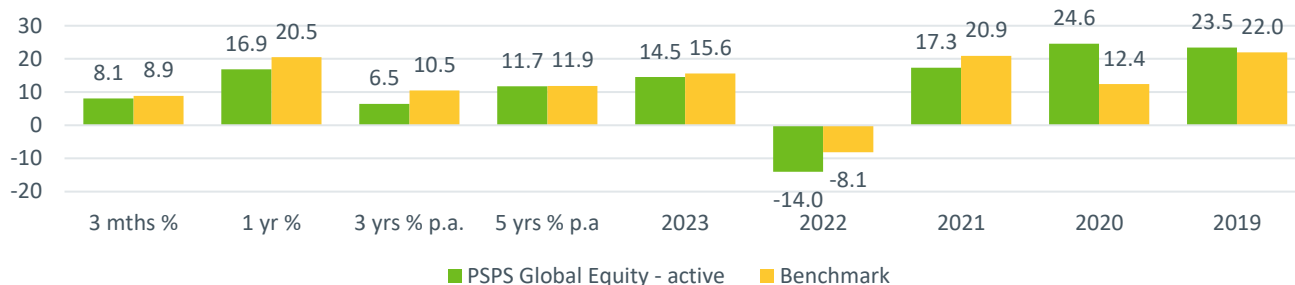
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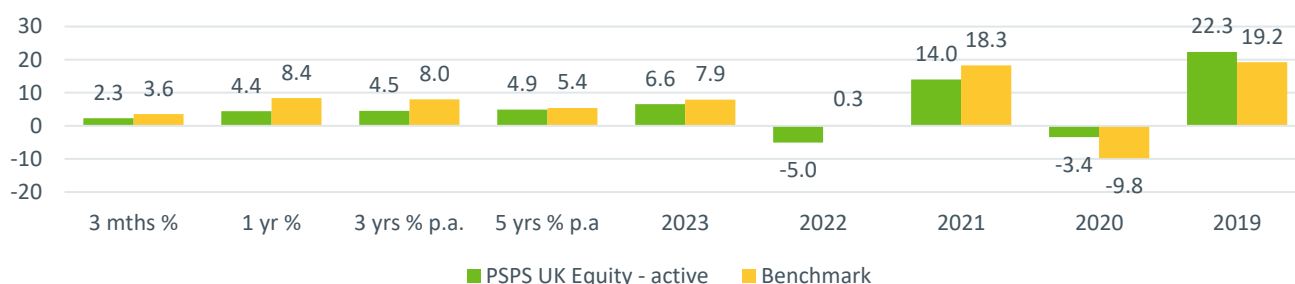
Appendix 1 – Performance of PSPS Funds (to 31/03/24)

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 March 2024.** (Source The Prudential Assurance Company Limited).

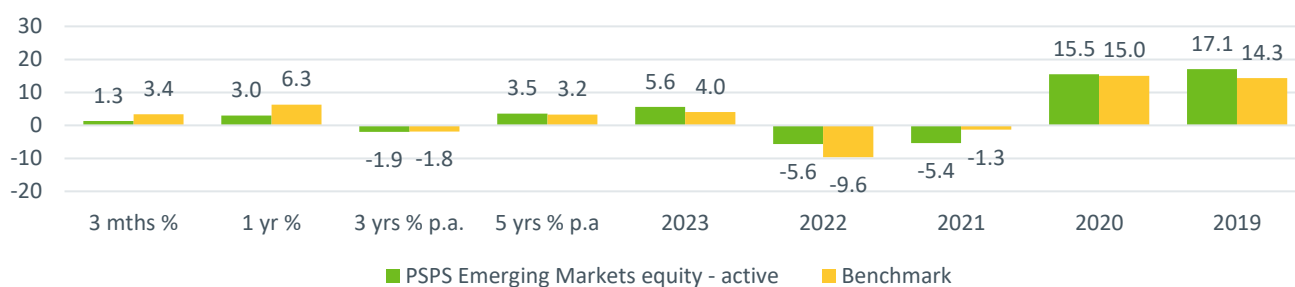
PSPS Global Equity - active



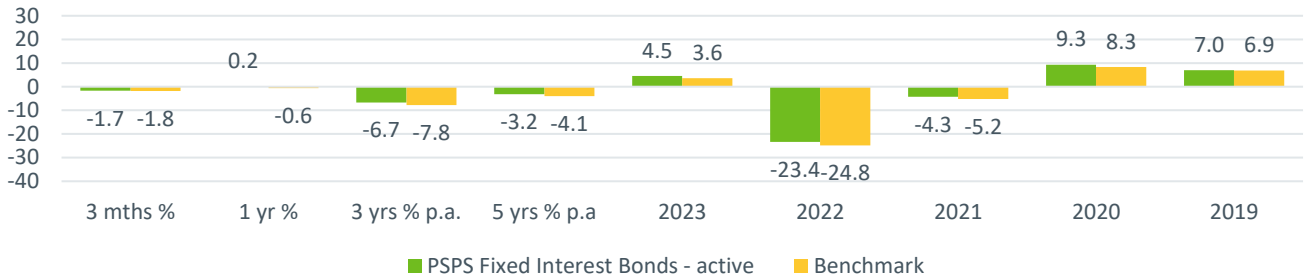
PSPS UK Equity - active



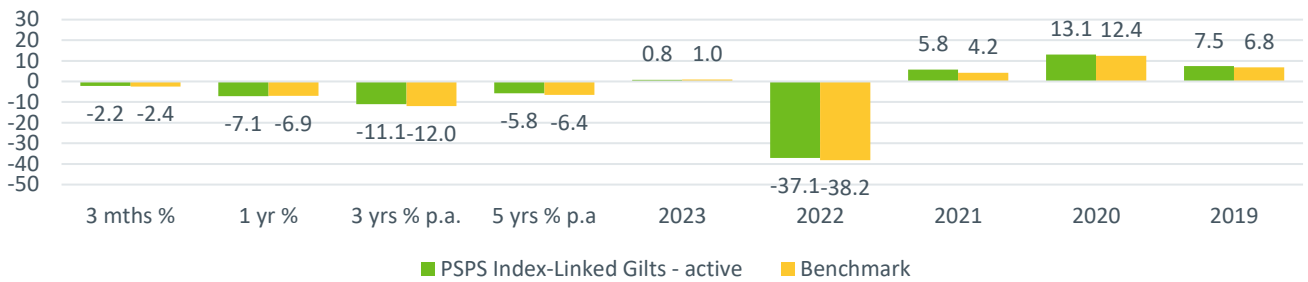
PSPS Emerging Markets equity - active



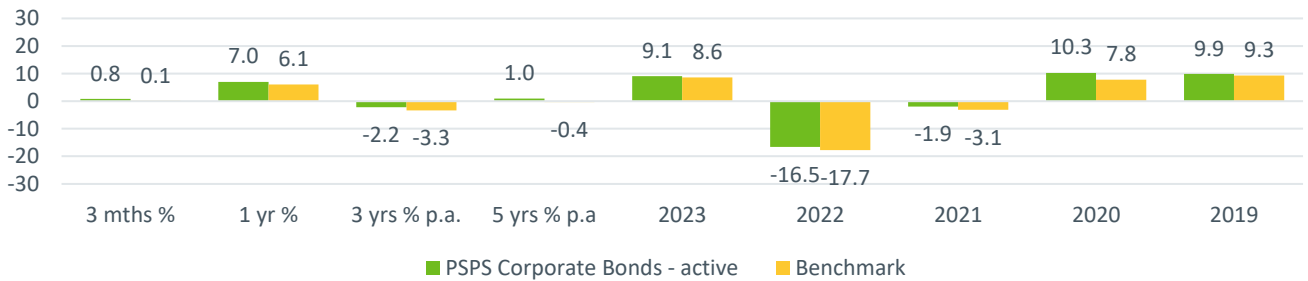
PSPS Fixed Interest Bonds - active



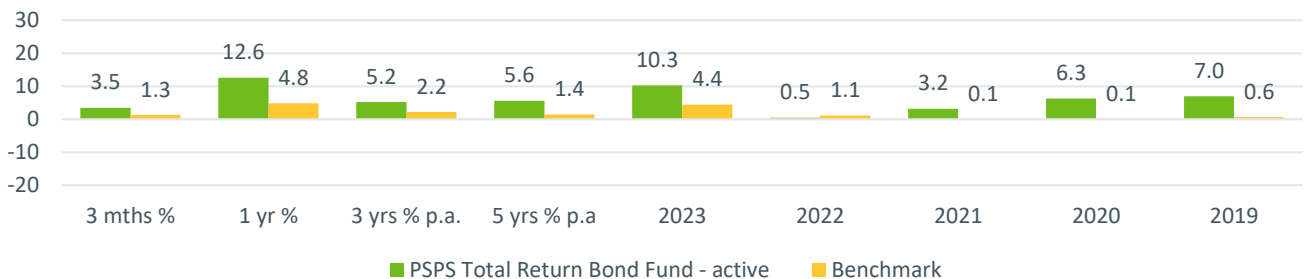
PSPS Index-Linked Gilts - active



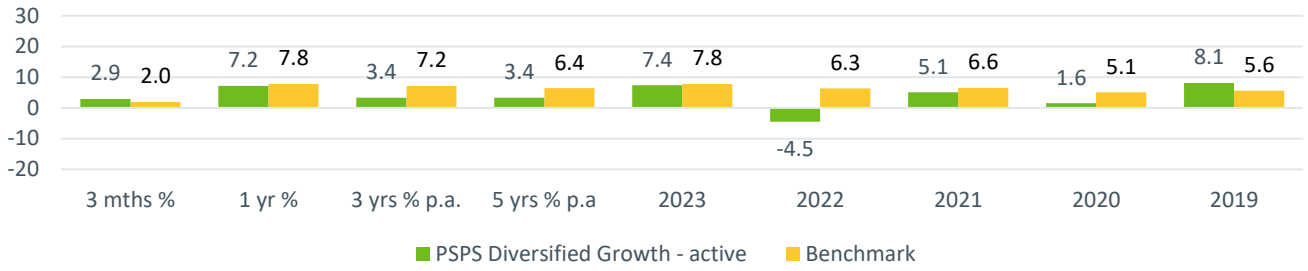
PSPS Corporate Bonds - active



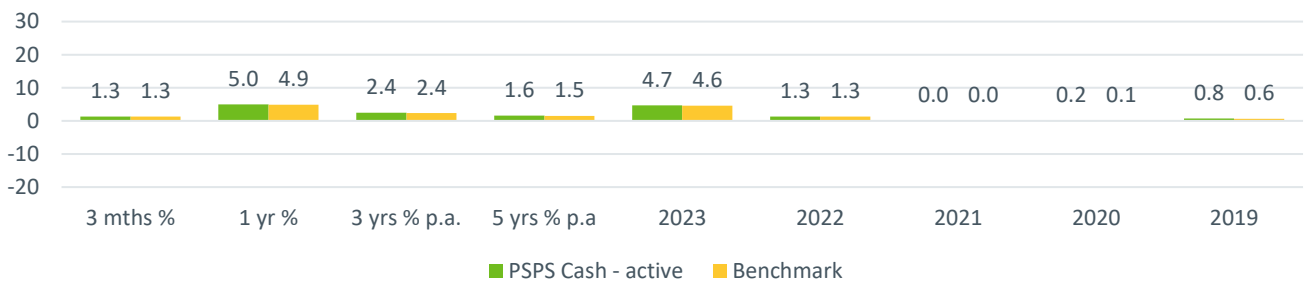
PSPS Total Return Bond Fund - active



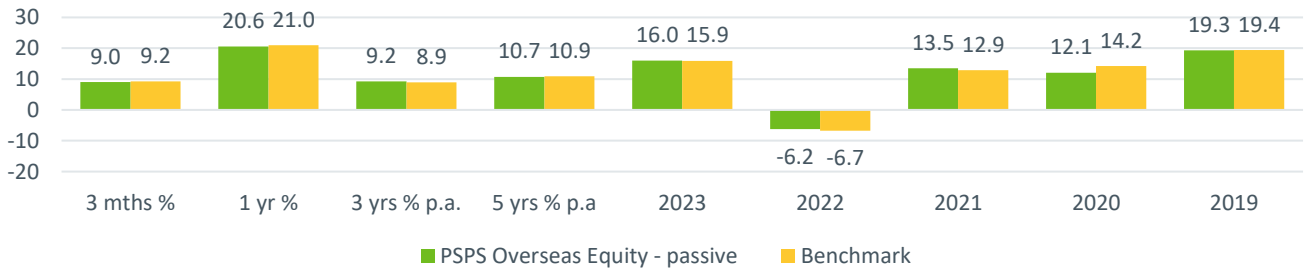
PSPS Diversified Growth - active



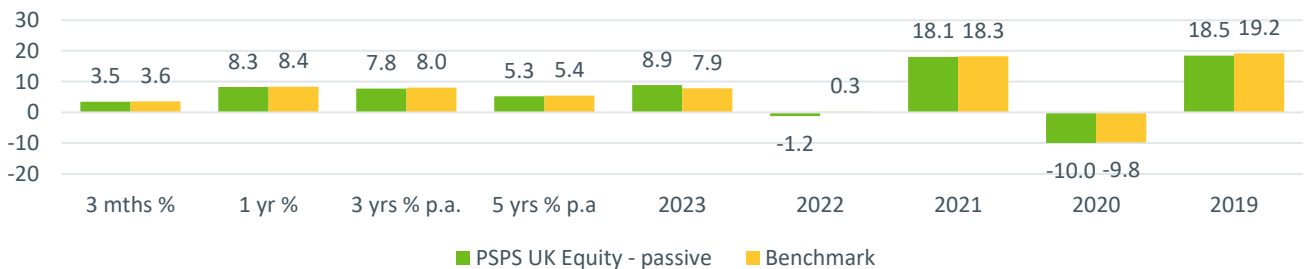
PSPS Cash - active



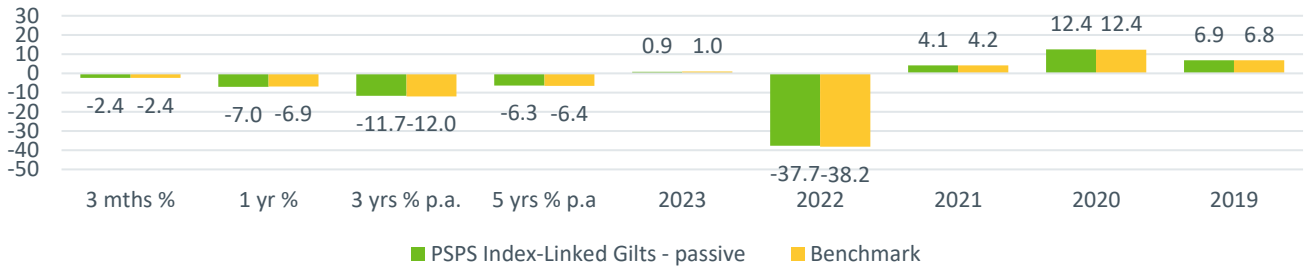
PSPS Overseas Equity - passive



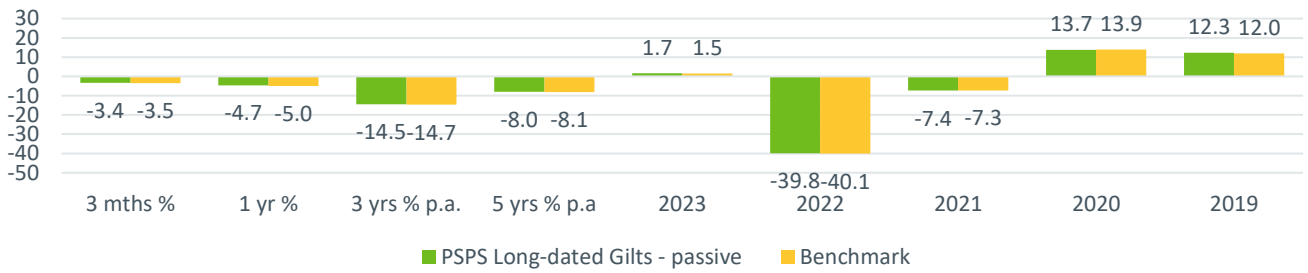
PSPS UK Equity - passive



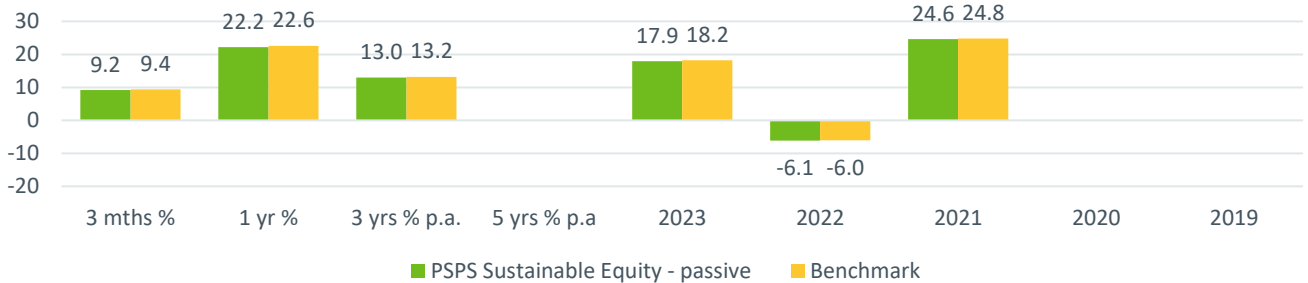
PSPS Index-Linked Gilts - passive



PSPS Long-dated Gilts - passive



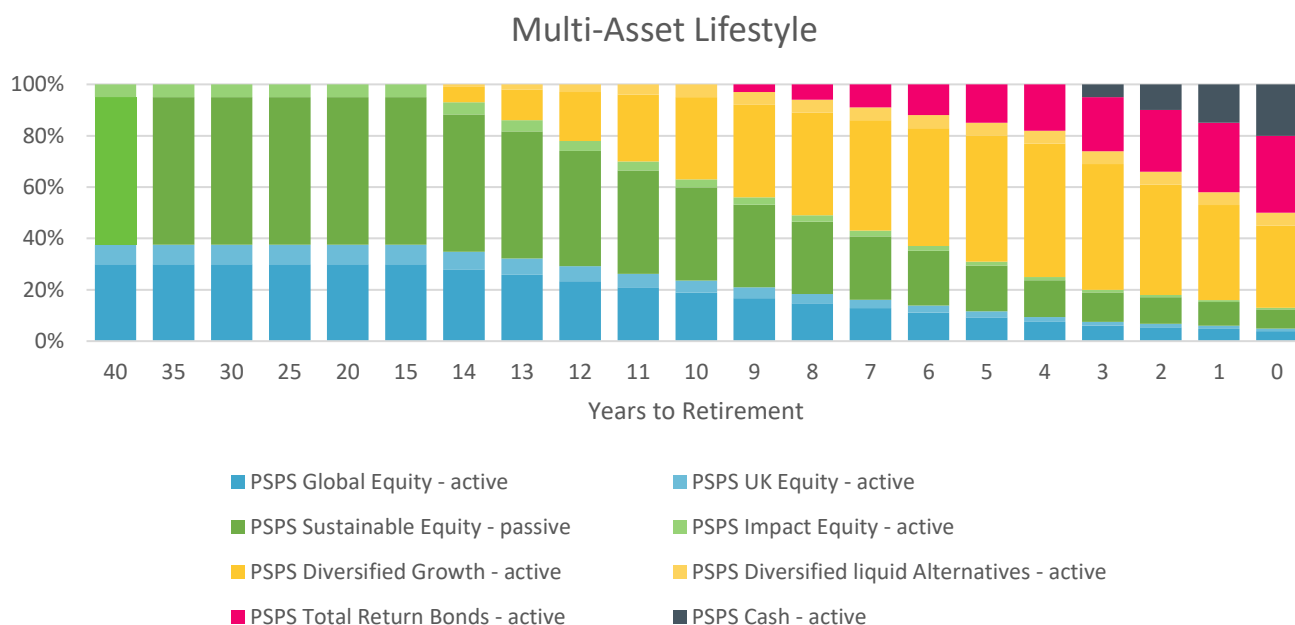
PSPS Sustainable Equity - passive



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 March 2024

Member - Years to Target Retirement Age	3 Months %	12 Months %	3 Years % p.a.	5 Years % p.a.
30 Years	8.1	18.6	8.1	9.8
10 Years	6.1	14.5	6.2	6.7
3 Years	3.9	10.4	4.6	5.0

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.