



**PRUDENTIAL**

**Staff Pension Scheme**

Defined Contribution Section

# Market commentary from the DC Section Investment Consultant



October 2024

*Your journey*

## Investment Markets and PSPS Funds Update – October 2024

### Introduction

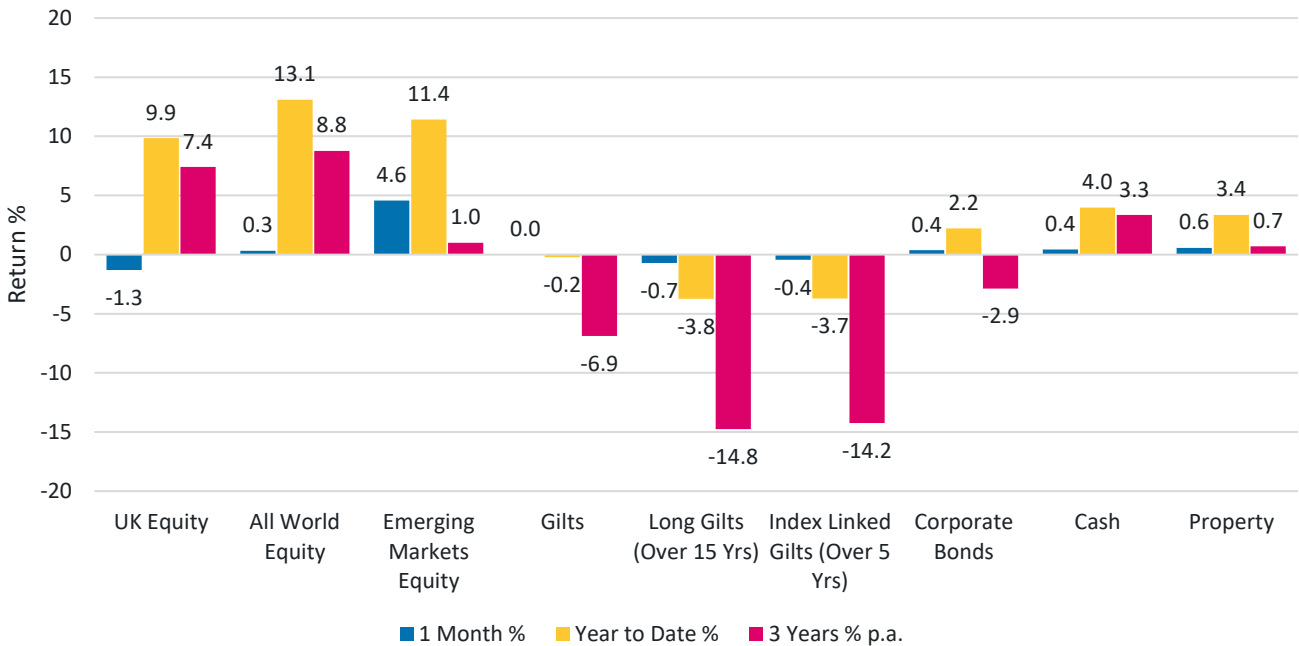
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Where the subject of this note refers to legal or tax matters, please note that Hymans Robertson LLP is not qualified to give such advice therefore we recommend that you seek independent advice on these matters.

### Performance of Investment markets

Market Returns (in Sterling) to 30 September 2024



Note: Property one month in areas. 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

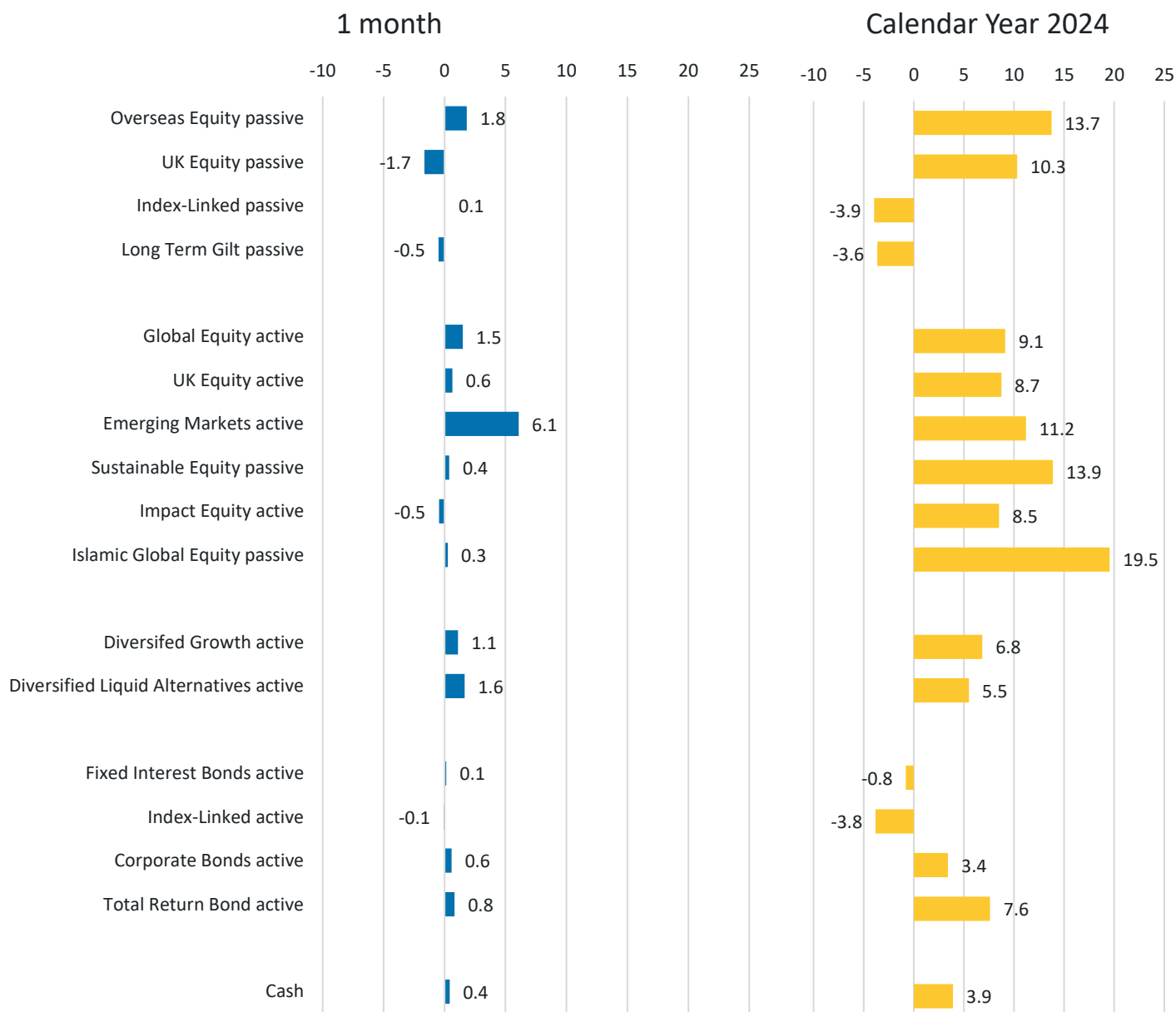
### Quarter 3 highlights

- Yields on sovereign bonds fell and prices rose in the third quarter (Q3). This was due to falling inflation and interest-rate cuts from the Bank of England (BoE), European Central Bank (ECB) and US Federal Reserve.
- Global equities fell sharply in early August, following the release of some disappointing US economic data and an unexpected BoJ rate increase, before rallying to produce decent positive returns. Interest-rate cuts

against a backdrop of slowing, but solid, growth and falling inflation, buoyed hopes of a soft economic landing.

- The equity market rally broadened in Q3, with 'value' stocks outperforming 'growth' and small caps outperforming large-cap stocks, as investors anticipated the benefits of lower interest rates.
- Emerging markets notched up the strongest regional performance in Q3, as Chinese policymakers delivered a raft of monetary and fiscal stimulus. Japan was the only developed-market index to end the quarter in the red, due to the yen's strength and the subsequent unwinding of yen carry trades.
- Credit spreads rose amid the early-August market volatility, but credit markets regained their poise to end the quarter a little tighter.
- The trade-weighted Japanese yen rose 8.7% in Q3 as the BoJ unexpectedly raised interest rates, while the equivalent US dollar measure fell around 2.7% as market-implied interest rates fell. Sterling gained 3% as signs of stubbornness in underlying inflation pointed to a more modest pace of interest-rate cuts than elsewhere.
- Despite rising tensions in the Middle East, oil prices fell 16.8% in Q3 as renewed softness in global manufacturing activity, slowing US growth and Chinese property market weakness weighed on demand.
- Gold prices continued their ascent, rising 13.2%, as interest-rate cuts and geopolitical tensions lent support.

The chart below shows the **estimated** performance (net of annual fees) of the PSPS funds for **September 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?

Emerging Markets Equities was the strongest performing fund over the month and most other funds produced a positive return. UK Equities (passive) Fund was the weakest performer over the month.

Strong positive returns across most funds over the calendar year with equities strongest.

### Lifestyle Returns

We show the estimated performance of the Multi-Asset Lifestyle in appendix 2 for periods to 30 June 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 – Quarter 3 2024

### The global economy

Stronger-than-anticipated US growth in Q2, which was confirmed at an annualised quarterly pace of 3.0%, has alleviated recent concerns that the US might be entering a recession. Indeed, data suggest the recent rise in unemployment, which contributed to the global equity sell-off in early August, was largely due to jobs growth being insufficient to absorb the increase in labour supply, as opposed to being driven by widespread layoffs.

Final GDP data showed the UK economy expanded at an above-trend quarterly pace of 0.5% in Q2, following 0.7% growth in Q1. Eurozone growth has been weaker, given its greater reliance on the struggling manufacturing sector and lacklustre demand from China: GDP growth in Q2 was revised down to 0.2% quarter on quarter in Q2, following a 0.3% expansion in Q1. Meanwhile, the Chinese economy expanded at a relatively subdued pace of 0.7% quarter on quarter in Q2, against a backdrop of weak consumption and ongoing weakness in the property market.

More timely purchasing managers' indices released in Q3 pointed to robust near-term global growth, as solid service sector expansion offset renewed manufacturing weakness. However, there has been a widening imbalance across regions and sectors. Service providers have experienced an ongoing expansion in activity, while conditions in the manufacturing sector have deteriorated further, with output, new orders and employment all contracting.

Global employment edged lower in August – the first job losses signalled by the survey since April. The US, China, and eurozone were among those to register cuts, whereas Japan, the UK, India and Brazil were some of the nations to see increased staffing. Average input and output charges both rose in August, albeit at slightly weaker rates than in the prior survey month, consistent with ongoing disinflation from elevated levels. September's flash data tended to support recent trends. US and UK surveys pointed to ongoing solid, but slowing, expansion, while eurozone data suggested the economy contracted in September.

US headline CPI inflation fell more than expected in August to 2.5% year on year, while equivalent UK and eurozone inflation, at 2.2% in both regions, was largely in line with expectations. Core inflation is still higher, at 3.2%, 3.5%, and 2.8% in the US, UK, and Europe, respectively. However, despite a larger-than-expected rise in UK core inflation, the downwards trend in underlying inflation pressures is largely intact.

Amid ongoing disinflation, the major central banks reduced interest rates in Q3. The ECB delivered its second cut of this cycle, reducing the deposit rate by 0.25% pa to 3.5% pa, while the BoE lowered interest rates by 0.25% pa to 5.0% pa. The Fed shifted focus to the employment aspect of its mandate and kicked off its rate-cutting cycle with a bumper 0.5% pa reduction in the Fed funds target range, to 4.75–5.0% pa. Market-implied interest rates also fell dramatically in Q3. At the end of June, markets were expecting the Fed funds rate to end 2024 at 5.0% pa and fall to 4.8% pa by the end of 2025. By the end of September, markets were expecting the Fed funds rate to end 2024

at 4.3% pa and fall to 2.9% pa by the end of 2025. In contrast to the other major central banks, the BoJ raised rates by 0.25% pa in Q3, with the rise and, more pertinently, hawkish rhetoric taking markets by surprise.

## Fixed income markets

### Sovereign bond yields fell as inflation and interest-rate expectations eased

US 10-year Treasury yields fell significantly by 0.6% pa to 3.8% pa, as inflation and interest-rate expectations eased and the Fed delivered its first interest-rate cut of the cycle – larger than usual at 0.5% pa. Equivalent German yields fell by 0.4% pa to 2.1% pa, as growth and inflation releases both came in lower than expected. UK 10-year gilts underperformed, declining by 0.2% pa to 4.1% pa, as stubborn wage and core inflation made the BoE more equivocal about the pace of future interest-rate cuts. Despite the surprise increase in Japanese interest rates, equivalent Japanese yields fell 0.2% pa to 0.9% pa, as the BoJ rowed back from its earlier hawkish comments.

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, eased by 0.2% pa to 3.3% pa, while the equivalent US measure fell 0.1% pa to 2.2% pa. Eurozone implied inflation fell more, by 0.3% pa to a below-target level of 1.7% pa.

### Credit spreads generally tightened

Credit spreads rose amid equity market volatility in early August but regained their poise to end the quarter slightly tighter. Global investment-grade credit spreads fell marginally, then remained at a relatively low level versus history at 1.0% pa. Equivalent speculative-grade credit spreads, which rose as much as 0.6% pa above end-June levels in early August, ended the quarter 0.2% pa lower at 3.3% pa – a low historic level. Tighter credit spreads likely reflect both strong yield-driven demand and benign default forecasts (consistent with a soft economic landing) made by the major credit rating agencies.

## Global equities

### Value outperformed growth and small-cap outperformed large-cap stocks

Global equities fell sharply at the beginning of August. Despite this, global equities bounced back and the FTSE All World Total Return Index finished the quarter up 5.1% in local-currency terms. Interest-rate cuts against a backdrop of slowing, but solid, growth and falling inflation, buoyed hopes of a soft landing for the global economy.

We saw a notable reversal in equity market leadership in Q3, as parts of the stock market that had previously suffered the most from high borrowing costs generally outperformed. Value outperformed growth and small caps outperformed large-cap stocks, in anticipation of the disproportionate benefit that small-cap stocks (typically heavily indebted) derive from interest-rate cuts. Utilities, which are often highly indebted and regarded as bond-like proxies due to their stable cashflows and defensive qualities, were by far the best-performing sector in Q3 as interest rates and bond yields fell. Industrials, financials, consumer staples, consumer discretionary and basic materials also modestly outperformed, in that order.

Energy was the worst-performing sector and the only one to deliver negative returns, as oil prices fell sharply against a backdrop of weaker demand. The technology sector also notably underperformed, despite reporting stronger-than-forecast results. Given high valuations, a moderation in the scale of earnings outperformance was enough to cause some high-profile tech stocks to fall. Healthcare and telecoms also underperformed, albeit modestly.

### **Emerging and Asia Pacific ex-Japan outperformed, as did North American equities**

Emerging markets and Asia Pacific ex-Japan staged a late-quarter rally, making them the best and second-best performing regions over the quarter. They benefited from officials unveiling a raft of policy support: the People's Bank of China's (PBoC) reduced its policy rate by 0.2% pa, lowered banks' reserve requirement by 0.5% and cut interest rates on existing mortgages by 0.5% pa. The central bank's governor suggested more policy stimulus might be on the way, and also revealed support for the stock market itself: the PBoC will provide loans to companies to buy back their own shares and allow securities companies and institutional investors to borrow, using shares and stock exchange-traded funds as collateral.

Despite the technology sector's underperformance, North American equities were the only other region to outperform in Q3, as the Fed's larger-than-expected interest-rate cut brought relief across sectors. US value stocks outperformed notably, while small-cap stocks rallied in anticipation of the benefit from expected rate cuts.

### **Japanese stocks trail peers**

Japanese stocks sold off sharply in early August, dropping more than 12% in the biggest one-day fall since 1987. The selloff was prompted by the BoJ's decision to hike interest rates, which coincided with a weak US datapoint, causing the interest-rate differential between the US and Japan to narrow. Consequently, the yen appreciated sharply, and investors began rapidly unwinding yen carry trades that were reliant on cheap Japanese borrowing costs. Sentiment improved following reassurances from the BoJ that it would closely consider market stability in future policy decisions, but Japanese stocks still ended the quarter 5% lower in local-currency terms.

Despite producing modest positive returns, Europe ex-UK and the UK also underperformed, in that order. Disappointing growth data, fresh signs of global manufacturing weakness and subdued Chinese activity have weighed on Europe's export-oriented markets. While UK economic data has been stronger and generally exceeded expectations, uncertainty around the UK autumn budget has weighed on consumer and business confidence. Exposure to the underperforming energy sector also detracted.

### **Currencies, commodities and property**

The trade-weighted Japanese yen rose 8.7% as an unexpected interest-rate rise, intervention by the BoJ and the unwinding of yen carry trades all supported the yen's rapid appreciation. The equivalent US dollar measure fell around 2.7% as interest rate-differentials between the US and other developed markets narrowed. Sterling gained close to 3% as signs of stubbornness in underlying inflation pointed to a more modest pace of interest-rate cuts than elsewhere.

Oil prices fell 16.8% in Q3, as renewed softness in global manufacturing activity, expectations that US growth will slow from its recent above-trend pace, and ongoing Chinese property market weakness weighed on demand expectations. Gold prices continued to rise, rising 13.2%, as expectations of interest-rate cuts and geopolitical tensions lent support.

Income drove a 1.0% rise in the MSCI UK Property Total Return Index in the quarter to end-August as aggregate capital values were little changed. Over a 12-month basis to end-August, the total return index rose 1.9% as income more than offset a 3.8% fall in aggregate capital values. Capital values continued to fall the most in the office sector, down 11.7% on an annual basis, though the pace of monthly declines has been easing over the past two years. Retail capital values have stabilised somewhat in recent months but remain 4.1% below the level seen this time last year. In contrast, industrial capital value rose a 0.4% over the 12 months.

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For and on behalf of Hymans Robertson LLP



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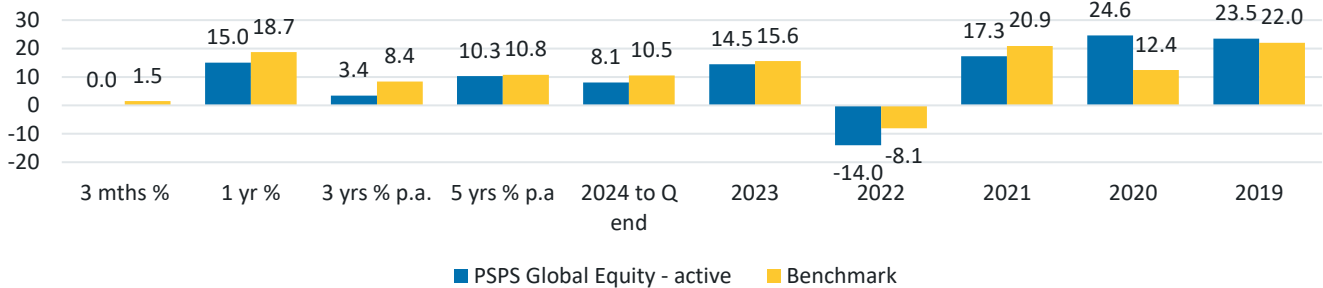
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# Appendix 1

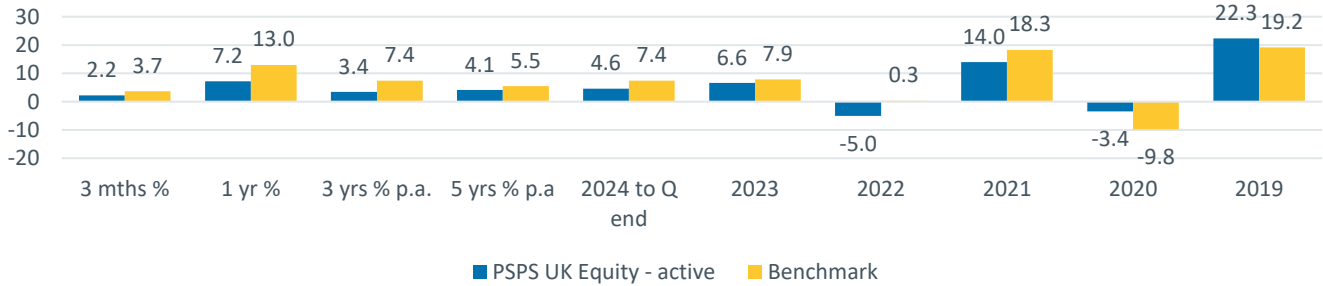
## Performance of PSPS Funds (to 30/06/24)

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 June 2024. (Source The Prudential Assurance Company Limited).

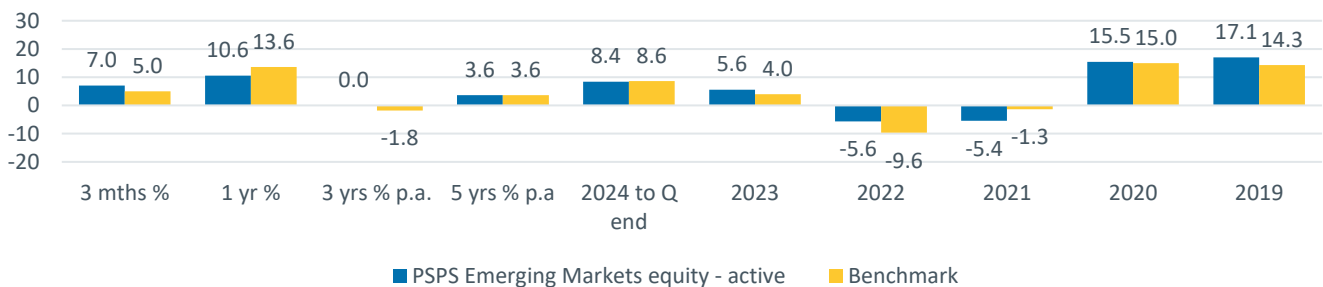
PSPS Global Equity - active



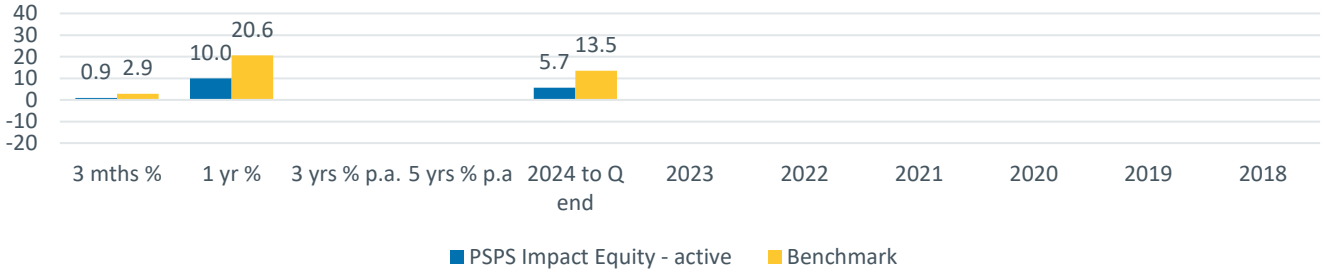
PSPS UK Equity - active



PSPS Emerging Markets equity - active

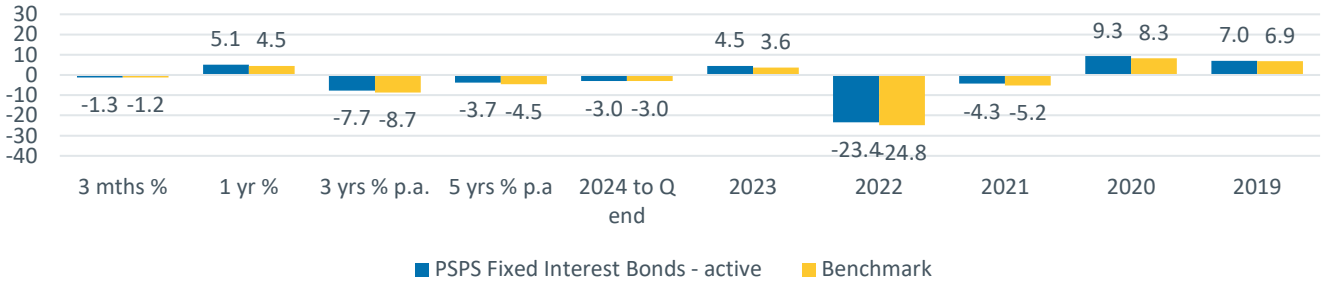


### PSPS Impact Equity - active

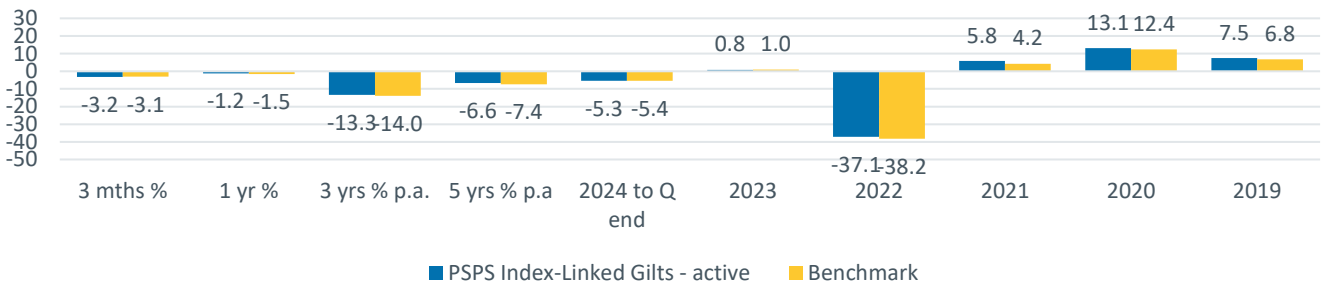


PSPS Impact Equity – active launched 11th May 2023

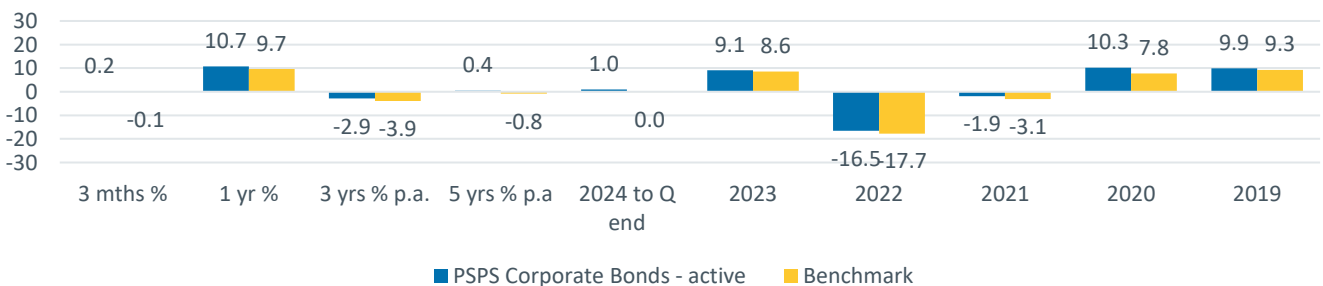
### PSPS Fixed Interest Bonds - active



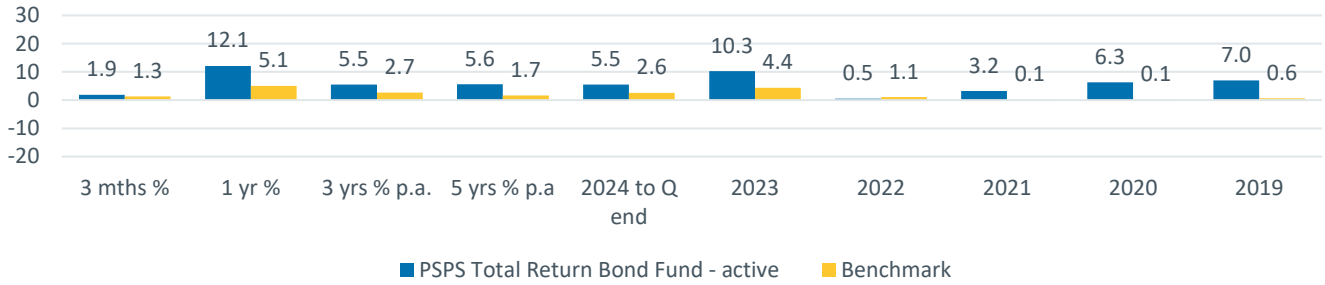
### PSPS Index-Linked Gilts - active



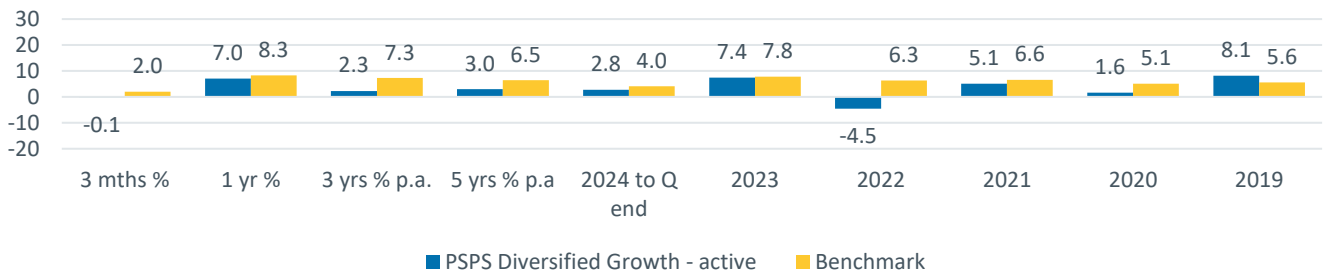
### PSPS Corporate Bonds - active



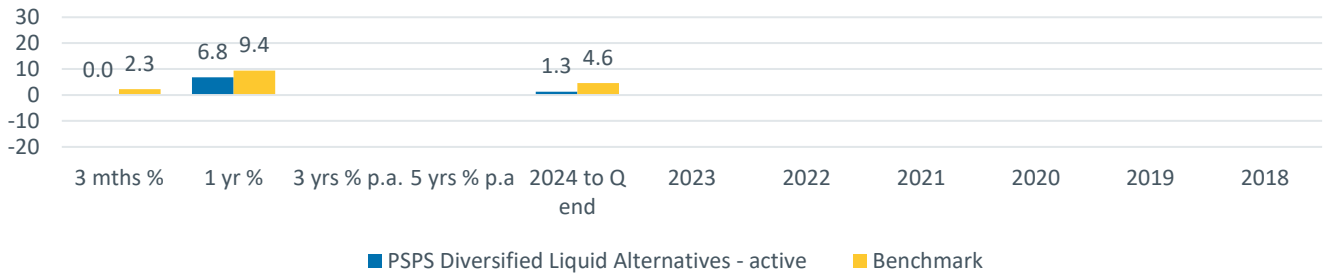
### PSPS Total Return Bond Fund - active



### PSPS Diversified Growth - active

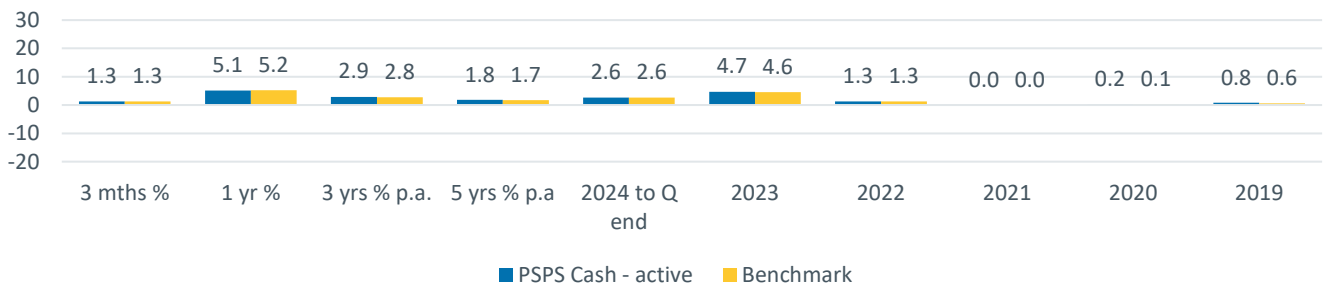


### PSPS Diversified Liquid Alternatives - active

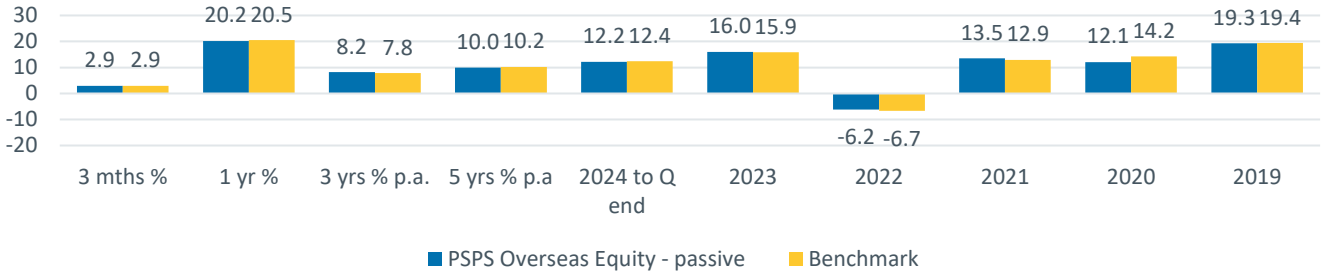


PSPS Diversified Liquid Alternatives – active launched 11th May 2023

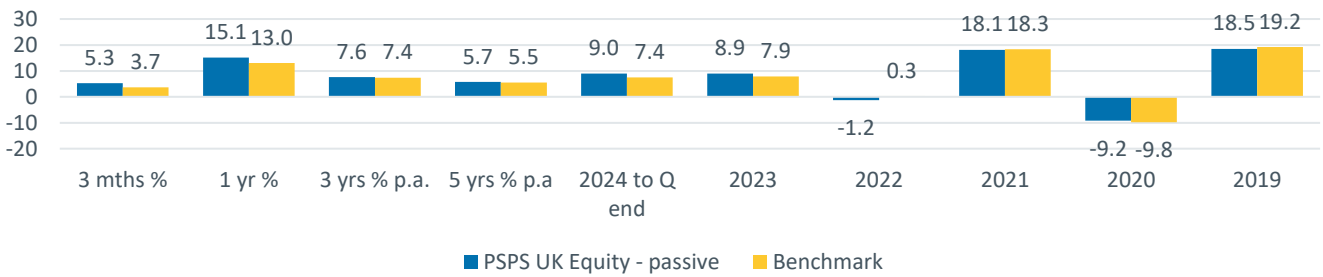
### PSPS Cash - active



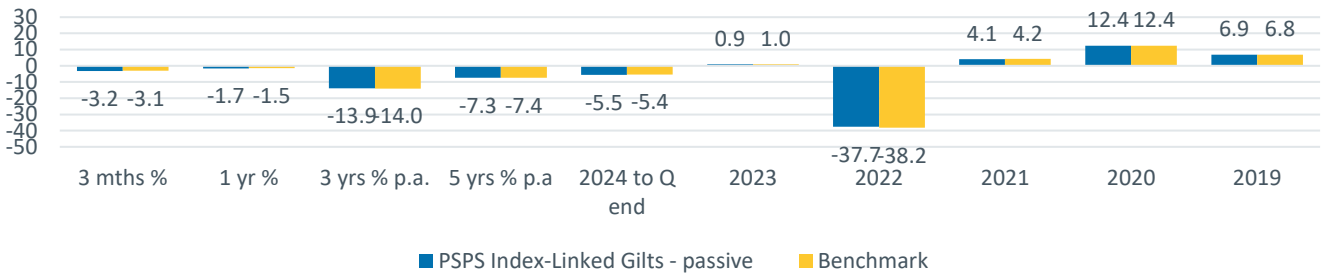
### PSPS Overseas Equity - passive



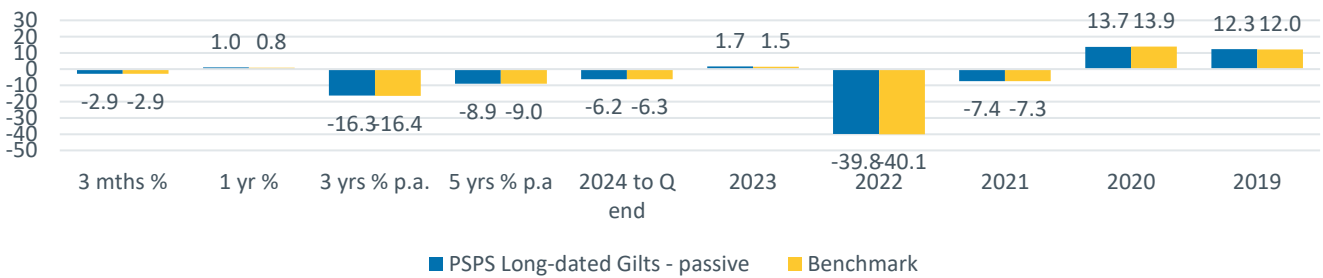
### PSPS UK Equity - passive



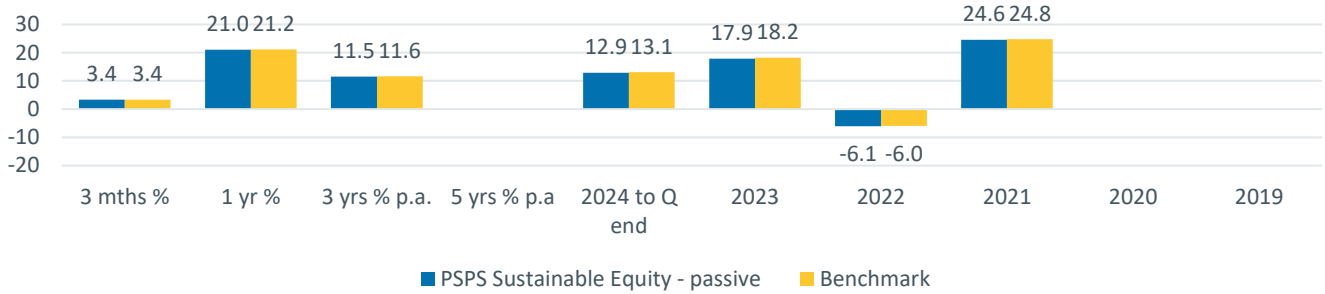
### PSPS Index-Linked Gilts - passive



### PSPS Long-dated Gilts - passive

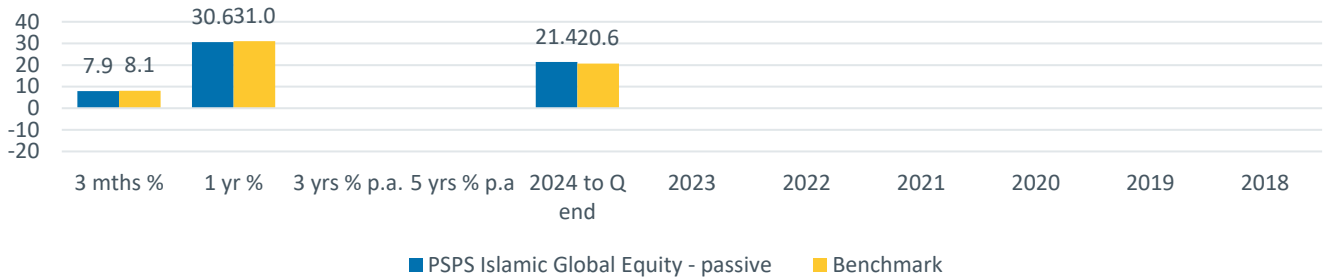


### PSPS Sustainable Equity - passive



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

### PSPS Islamic Global Equity - passive

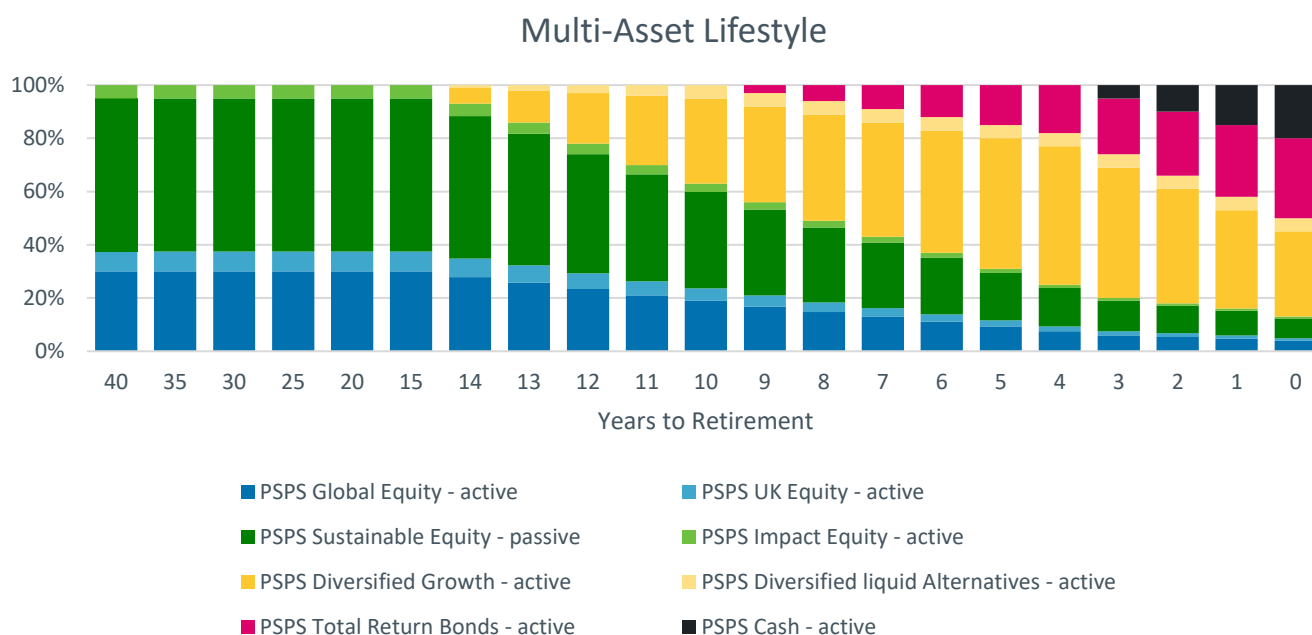


PSPS Islamic Global Equity – passive launched 11th May 2023

# Appendix 2

## 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 30 June 2024

Member - Years to Target Retirement Age	3 Months %	12 Months %	3 Years % p.a.	5 Years % p.a.
<b>30 Years</b>	2.2	17.6	6.7	9.1
<b>10 Years</b>	1.3	13.7	5.2	6.4
<b>3 Years</b>	0.8	10.1	3.8	4.7

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.