M&G

PRUDENTIAL
Staff Pension Scheme
Defined Contribution Section

Market commentary from the DC Section Investment Consultant

January 2025

Your journey

Investment Markets and PSPS Funds Update – January 2025

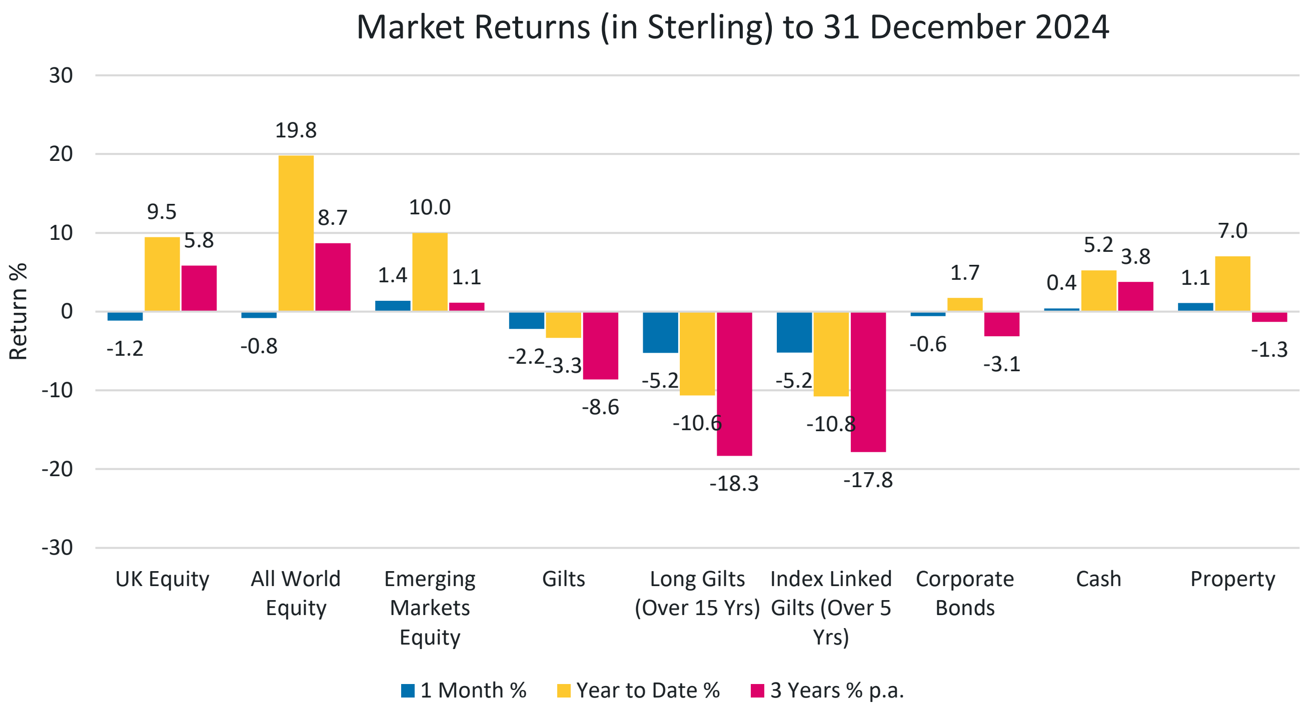
Introduction

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.

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



Source: Datastream

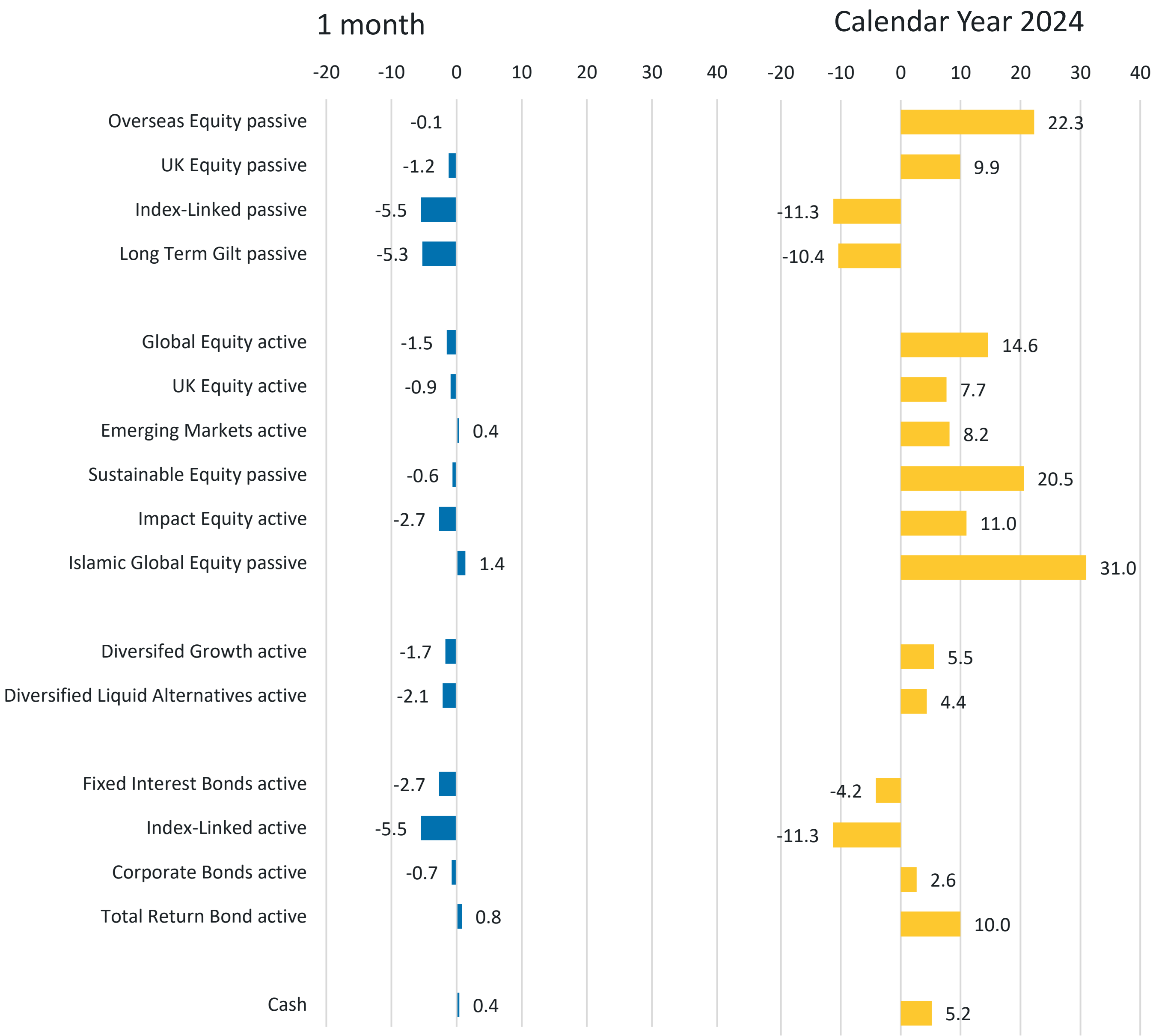
Indices: FTSE All Share, FTSE All World £, FTSE All Emerging £, FTSE British Govt Over 15Y, FTSE British Govt Index Linked Over 5Y, iBoxx Sterling Non-Gilts, SONIA, MSCI UK Monthly property

Quarter 4 2024 highlights

- Data released in Q4 showed the US economy continued to grow strongly in Q3, at annualised pace of 3.1%, while eurozone GDP rose a more modest 0.4% quarter-on-quarter and the UK economy stagnated.
- Timelier Composite Purchasing Managers' Index (PMI) data suggest transatlantic disparity continued in Q4: surveys indicate US activity expanded at its fastest pace in three years in December but point to contraction in the eurozone and stagnation in the UK, as service-sector expansion was offset by manufacturing weakness.

- In November, year-on-year headline CPI rose to 2.7%, 2.6% and 2.3% in the US, UK and eurozone, respectively, largely owing to a smaller drag from energy prices. Core inflation, which excludes volatile energy and food prices, remained at 3.3% and 2.7% in the US and eurozone, respectively, but rose to 3.6% in the UK.
- Central banks looked through the rise in headline inflation, as the US Federal Reserve (Fed) and European Central Bank (ECB) both reduced rates a cumulative 0.5% pa, to 4.25–4.5% pa and 3.0% pa, respectively. Given signs of more persistent inflation, the Bank of England (BoE) reduced rates less, cutting 0.25% pa to 4.75% pa.
- Despite interest-rate cuts, sovereign bond yields rose as inflation, and interest rate, expectations crept up, and markets anticipated heavier bond supply. Nonetheless, global credit spreads continued to grind tighter.
- Global equities fell in December as yields rose, but still gained 1.3% in Q4. Japan outperformed as ongoing yen weakness supported the export-heavy market. The US also outperformed as domestically focused stocks were buoyed by President-elect Trump's expected policy agenda of tax cuts and deregulation.
- Expectations of higher-for-longer US rates than elsewhere saw the trade-weighted dollar rise a further 6.4%, while equivalent yen, sterling and euro measures fell 4.5%, 1.5% and 2.0%, respectively. Gold prices fell 0.3%, after hitting new highs in October, amid dollar strength and profit-taking by investors.

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

Negative returns across most funds over the month with gilts the weakest performers. Bond yields globally have increased (prices fallen) with expectations of inflationary pressures from the expected tax reduction, tariff increase and government spending by the new US administration.

Strong positive returns across most funds over the year with equities strongest. Only Gilt funds performed negatively over 2024.

Lifestyle Returns

We show the estimated performance of the Multi-Asset Lifestyle in appendix 2 for periods to 30 September 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.

Members who are in the legacy Active and Passive Lifestyles Targeting Annuity Purchase and are in the de-risking phase (less than 10 years to retirement), will have been exposed to gilts and index-linked gilts to a significant extent that have produced negative returns over 2024. These legacy lifestyles are designed for people seeking to purchase an annuity at retirement with their DC pot. Typically, falling gilt values (and higher yields) is accompanied by improved annuity rates, offsetting the negative performance

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 4 2024

The global economy

US GDP data released in December confirmed robust annualised growth of 3.1% in Q3, above earlier estimates of 2.8%, and ahead of the 3% pace set in Q2. The US Flash Composite PMI suggests private sector activity expanded at its fastest pace in nearly three years in December, driven by strong demand and a surge in new orders. Business optimism improved significantly, reflecting reduced uncertainty following the election and anticipated growth-friendly policies from the new administration. However, this growth stayed heavily weighted towards the services sector, with the manufacturing sector continuing to contract, owing partly to weak export demand.

The UK economy slowed from H1's above-trend pace and unexpectedly stagnated in Q3. The December Flash Composite PMI remained slightly above the neutral 50 mark, representing a marginal increase in output, despite the manufacturing sector PMI figure hitting an 11-month low. The eurozone economy grew 0.4% in Q3, matching estimates and improving on H1 2024, despite the largest contraction in exports since Q2 2020 weighing on activity. The eurozone PMI showed a contraction in output, amid ongoing manufacturing sector weakness. Business surveys in both regions cited falling new orders, rising input costs and waning confidence for the year ahead.

As forecast, US and UK headline CPI inflation continued to rise to 2.7% and 2.6%, respectively, in November, while the eurozone's headline CPI rose less than expected, to 2.2%. The increases reflect a smaller negative impact from energy prices relative to last year's sharp declines. Year-on-year core inflation, which excludes volatile energy and food prices, remained at 3.3% and 2.7% in the US and eurozone, and rose to 3.6% in the UK.

Central banks looked through the rise in headline inflation, as the Fed and ECB both reduced rates a cumulative 0.5% pa, to 4.25–4.5% pa and 3.0% pa, respectively. Given signs of more persistent inflation, the BoE reduced rates less, cutting 0.25% pa to 4.75% pa. The Fed signalled a slower pace of easing in 2025, while policymakers also raised their inflation estimates for next year. The BoE also lifted its 2025 and 2026 inflation projections following October's UK budget, where spending and borrowing were increased more than expected. At the end of December, markets were expecting just two rate cuts from the BoE and Fed in 2025, down from five at the end of September.

Fixed income markets

Sovereign bond yields rose significantly

US 10-year sovereign bond yields rose 0.8% pa, to 4.5% pa. Strong US economic data, expectations that Trump's policy agenda of tax cuts and tariffs will be inflationary, and anticipation that issuance will remain high to fund the large fiscal deficit contributed to the rise. UK 10-year sovereign bond yields rose 0.6% to 4.6% pa, jumping after the Autumn Budget. The budget was expected to be inflationary, which raised interest-rate expectations, but the market also reflects the risk of higher future gilt issuance. As a result, term premia (the additional amount required by investors to hold a long-term instrument versus a short-term deposit) also rose.

French 10-year government bond yields rose 0.3% pa to 3.2% pa, as the government's failure to pass a budget, and its subsequent collapse, saw Moody's downgrade France's debt rating. Equivalent German yields also rose 0.2% pa to 2.4% pa. Japanese 10-year government bond yields rose 0.2% pa to 1.1% pa, as investors expect the Bank of Japan to continue to raise interest rates.

UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, rose by 0.1% pa, to 3.5% pa. The equivalent US measure rose 0.2% pa, to 2.3% pa.

Credit spreads continued to grind tighter

Credit spreads fell over the quarter, continuing the year-to-date trend. Global investment- and speculative-grade credit spreads fell 0.1% pa and 0.2% pa, to 0.9% pa and 3.1% pa, respectively, remaining close to historic lows. Low credit spreads 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

Japan and North America outperformed

The FTSE All World Total Return Index rose 1.3% in local-currency terms in Q4, despite a sell-off in December as the Fed's hawkish rhetoric after its December rate cut weighed on sentiment. US equities outperformed, given strong growth and expectations that President-elect Trump's tax cuts and deregulation will lend further support. Domestically oriented stocks outperformed in the aftermath of the election result, buoyed by anticipation of the impact on domestic demand from tax cuts. At the same time, large-cap tech stocks continued to produce strong returns.

Having been the worst-performing region in Q3, Japan was the best-performing region in Q4. Yen weakness boosted expected earnings from the export-heavy market, while sentiment also improved following reassurances from the Bank of Japan that it would closely consider market stability in future policy decisions, given the sharp sell-off in Q3. The region was also boosted by positive dealmaking news and increased share buybacks.

All the major regions underperformed

Trump's return to the White House did not augur well for equity returns outside the US. The prospect of increased trade frictions, expectations of higher-for-longer US interest rates and a stronger US dollar all weighed on market sentiment. Emerging market and Asian equities declined the most, having also been impacted by an underwhelming stimulus packaged announced by the Chinese authorities, given ongoing property challenges and low consumer confidence.

Europe ex-UK equities also underperformed due to concerns over US trade policy, ongoing weakness in the region's crucial manufacturing sector and increased competition from low-cost Chinese imports. Fragmented politics in France and Germany, and weak demand for exports from China, also weighed on the region more broadly. The UK underperformed due to below-average exposure to the outperforming technology sector.

Consumer discretionary was the best-performing sector

Sectoral performance was influenced by expectations about Trump's presidency. Consumer discretionary led, supported by strong US macroeconomic data and the expectation that personal tax cuts will be extended. Technology stocks continued to outperform, despite a drop off in December as investors cashed in the large gains of 2024. Financials also outperformed, benefiting from expectations of a lighter regulatory approach and an expected pick-up in deal making, as well as higher-for-longer interest rates, which boost net-interest income and earnings.

Basic materials was the worst-performing sector, weighed down by weak economic data from the eurozone and subdued Chinese activity, and a subsequent decline in industrial metals prices. Healthcare stocks followed closely, declining after Trump's presential election win due to expectations the new administration may be more hostile towards the pharmaceutical industry. Consumer staples, utilities, energy, industrials and telecoms also underperformed, in that order.

Currencies and commodities

Expectations that US interest rates will remain higher for longer and the potential impact of tariffs on the competitiveness of other countries' exports saw the trade-weighted US dollar rise 6.4%. Equivalent sterling and Japanese measures fell 1.5% and 4.5%, respectively, as some prior gains against the dollar unwound, while the euro fell 2.0%.

Oil prices rose 3.9%, but remain relatively low, at $75 per barrel, as the potential supply impact from ongoing conflict in the Middle East was weighed against soft demand due to subdued Chinese activity and global manufacturing weakness. Despite reaching new highs in October, gold prices fell 0.3% due to a stronger dollar and profit-taking by investors, given gold's rally this year.

The MSCI UK Property Total Return Index rose 1.7% quarter-to-date to end-November, driven by income and a rise in capital values. The 12-month total return to end-November edged up to 5.4%, as declines in capital values moderated. Capital values continued to fall in the office sector month on month, but, given rises in industrial and retail capital values, the aggregate decline eased to 0.5% over the 12 months to end-November.

Mark Jaffray	David Millar
Partner	DC Investment Consultant

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.

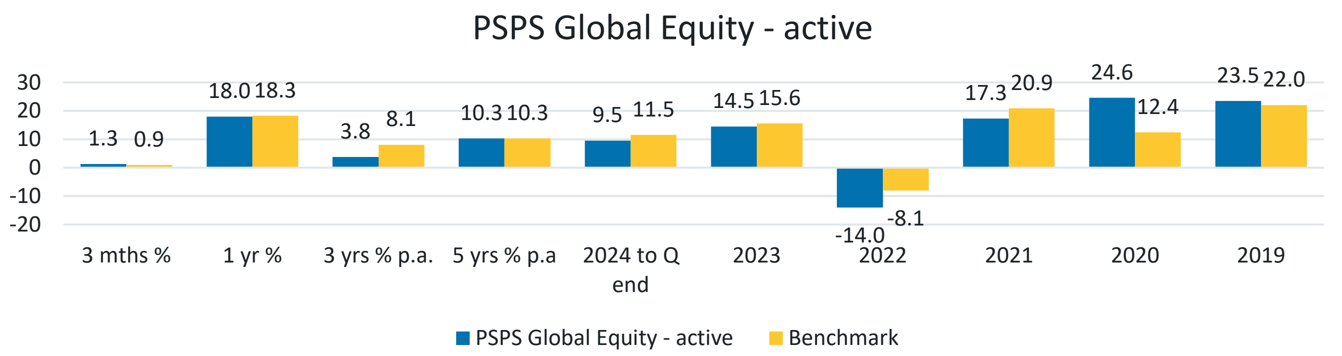
This communication has been compiled by Hymans Robertson LLP® (HR) as a general information summary and is based on its understanding of events as at the date of publication, which may be subject to change. It is not to be relied upon for investment or financial decisions and is not a substitute for professional advice (including for legal, investment or tax advice) on specific circumstances. It contains confidential information belonging to Hymans Robertson LLP (HR) and should not be disclosed to any third party without prior consent from HR, except as required by law.

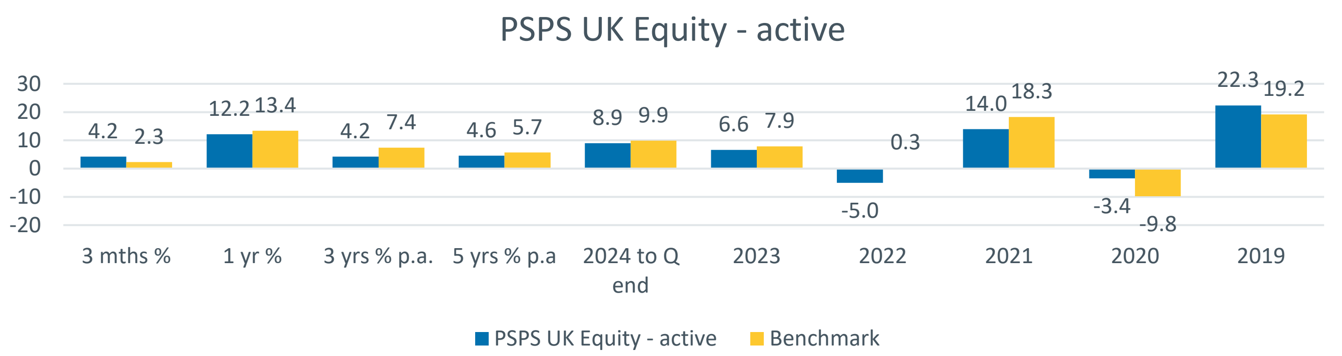
HR accepts no liability for errors or omissions or reliance on any statement or opinion. Where we have relied upon data provided by third parties, reasonable care has been taken to assess its accuracy however we provide no guarantee and accept no liability in respect of any errors made by any third party.

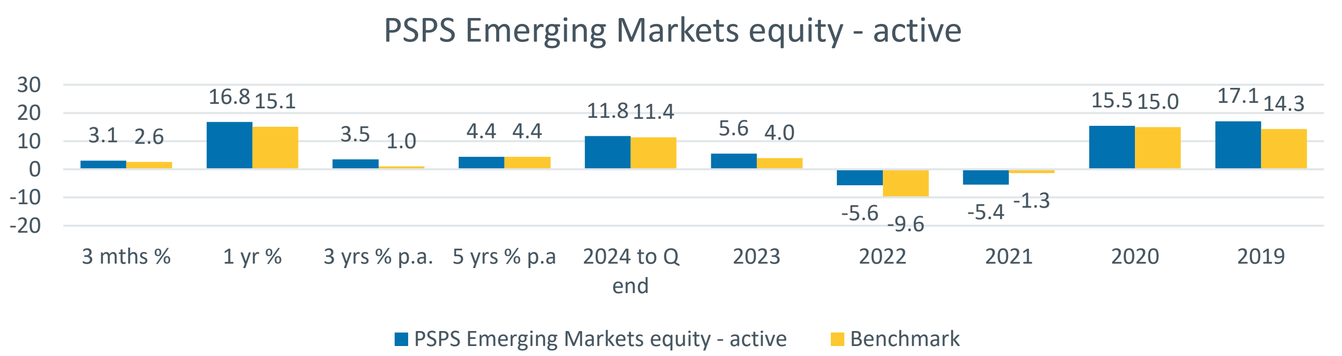
Appendix 1

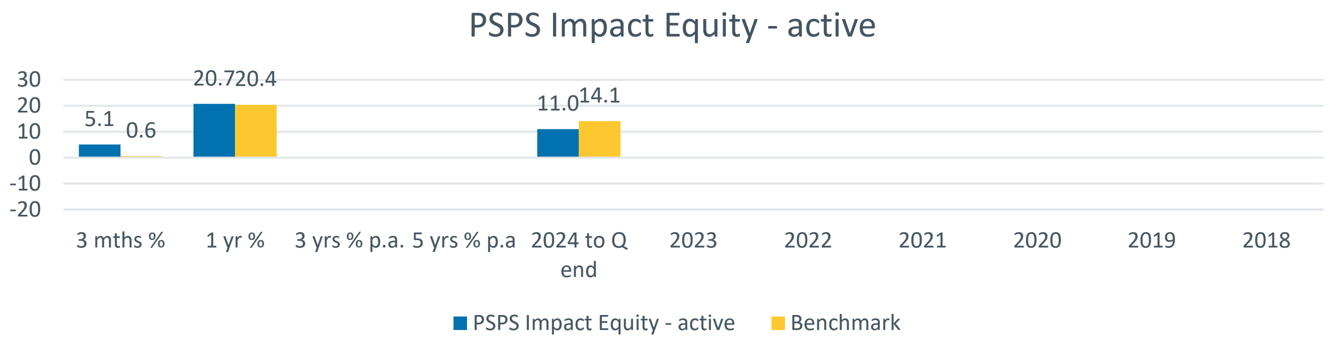
Performance of PSPS Funds (to 30/09/24)

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

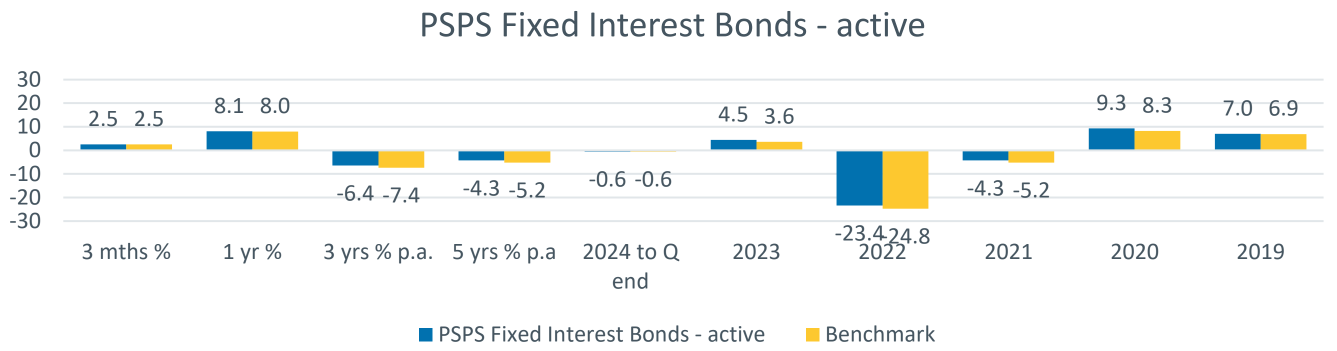


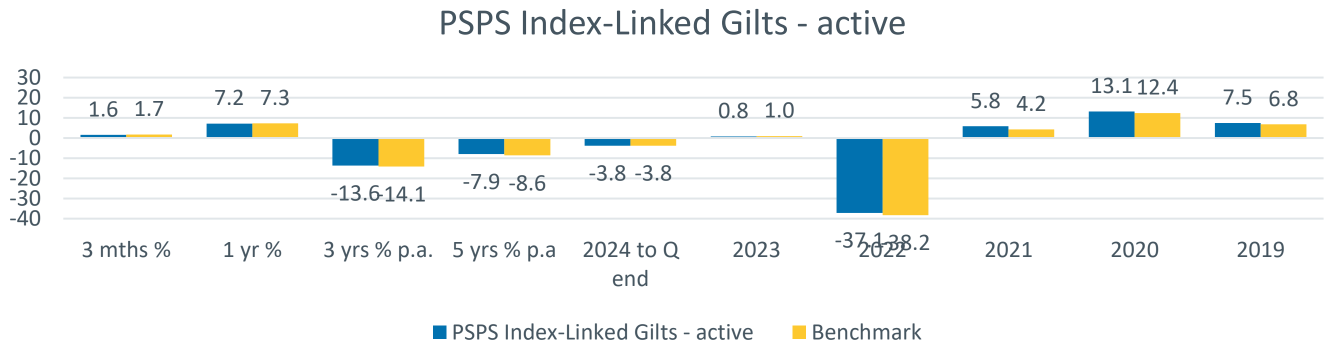


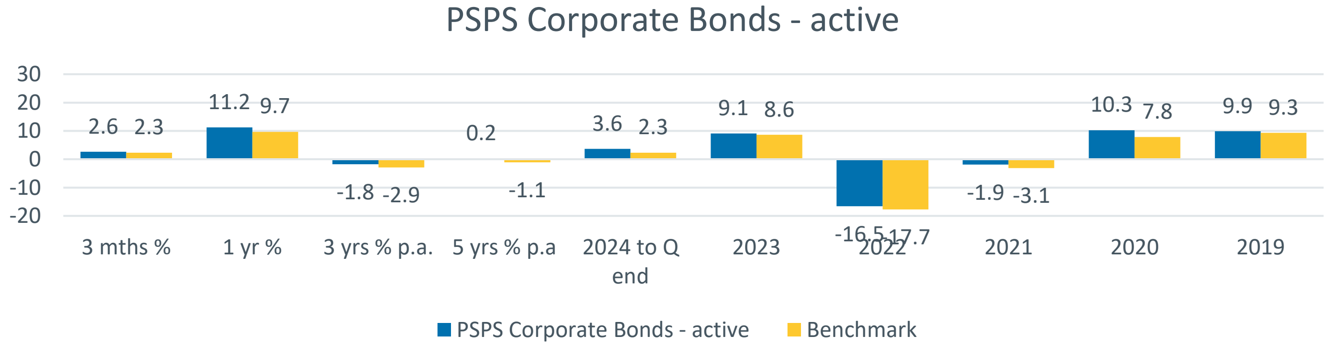


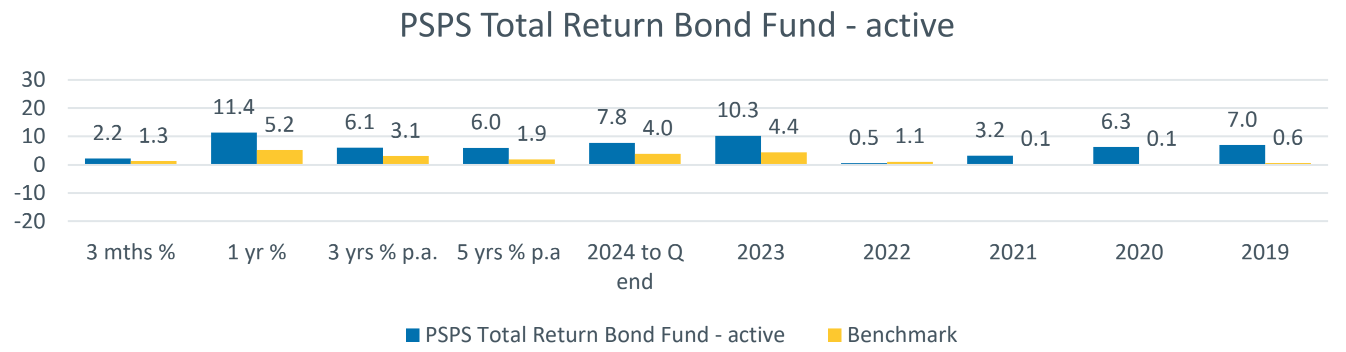


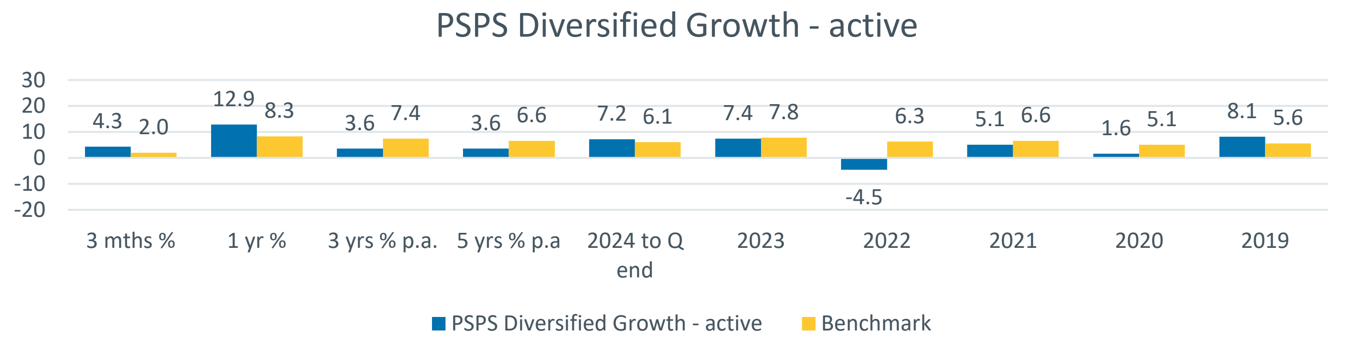
PSPS Impact Equity – active launched 11th May 2023

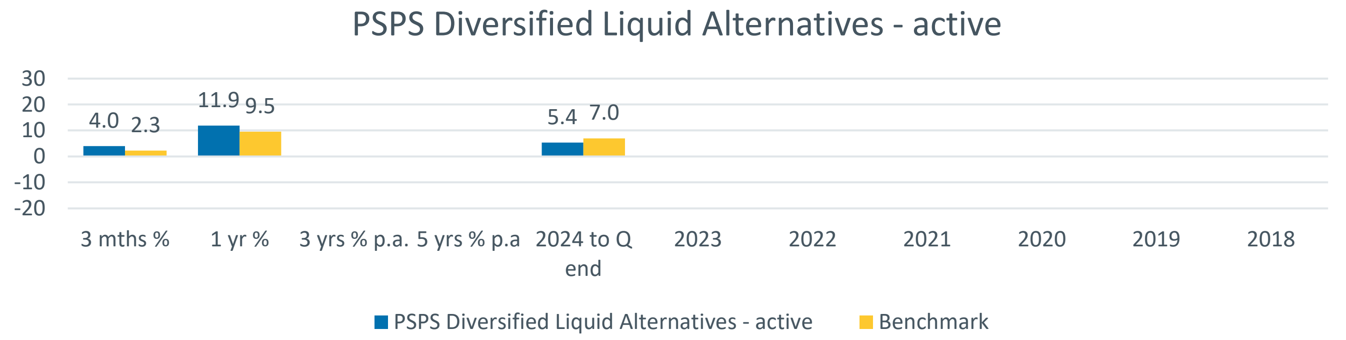




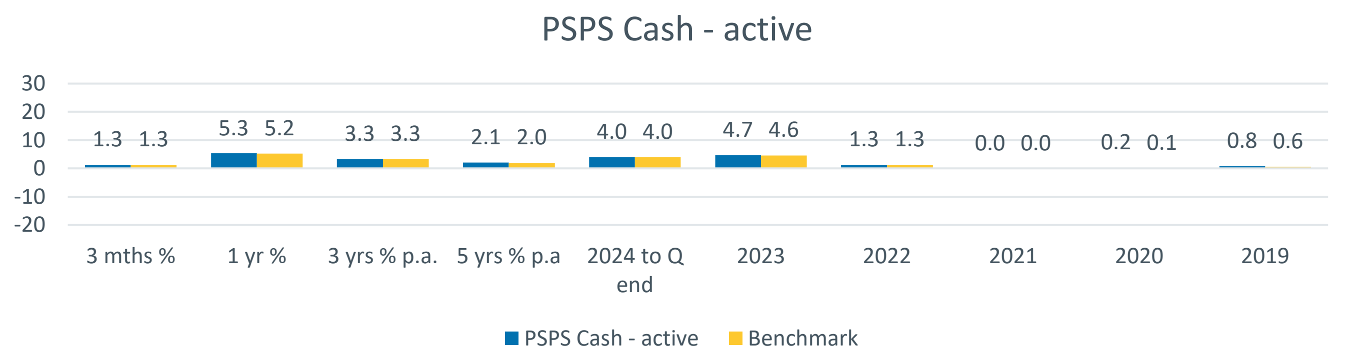




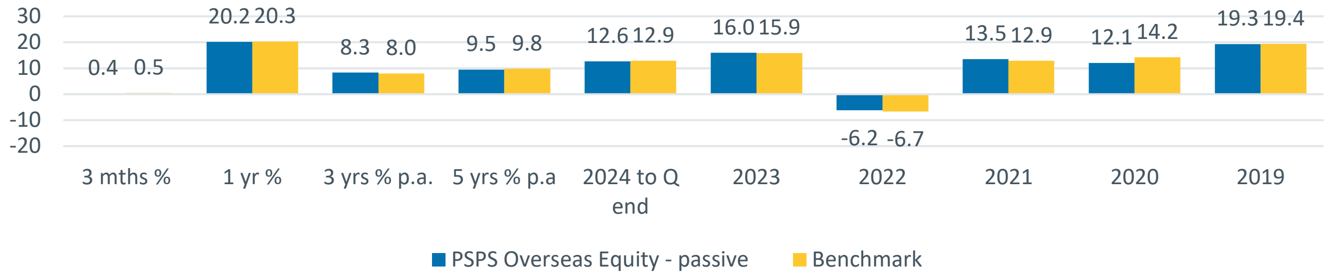




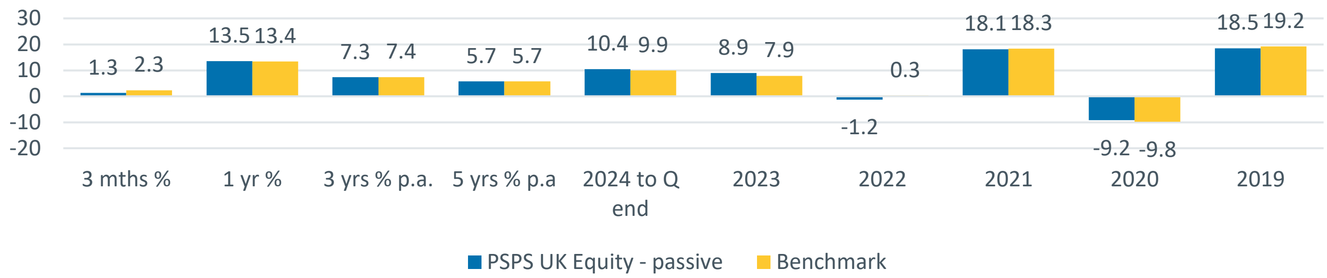
PSPS Diversified Liquid Alternatives – active launched 11th May 2023



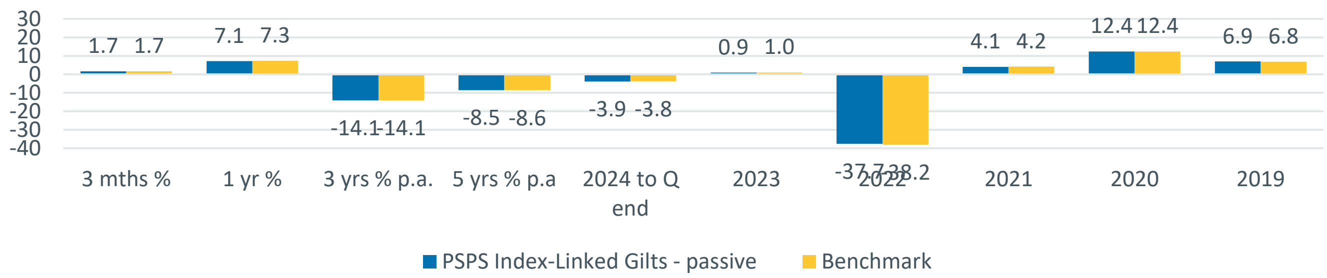
PSPS Overseas Equity - passive



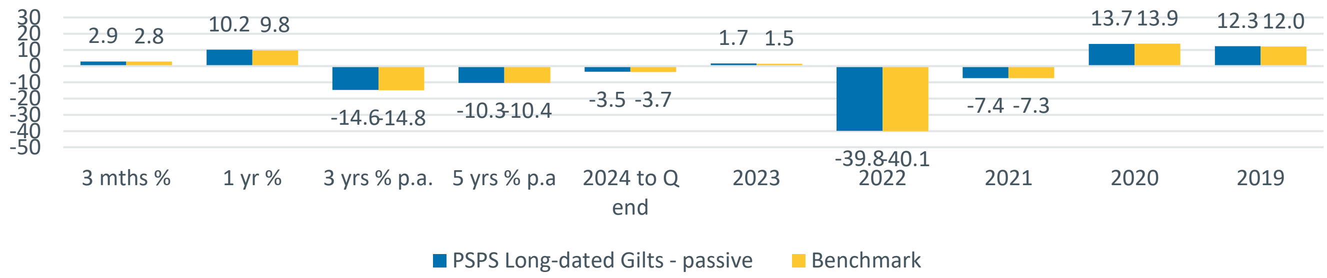
PSPS UK Equity - passive

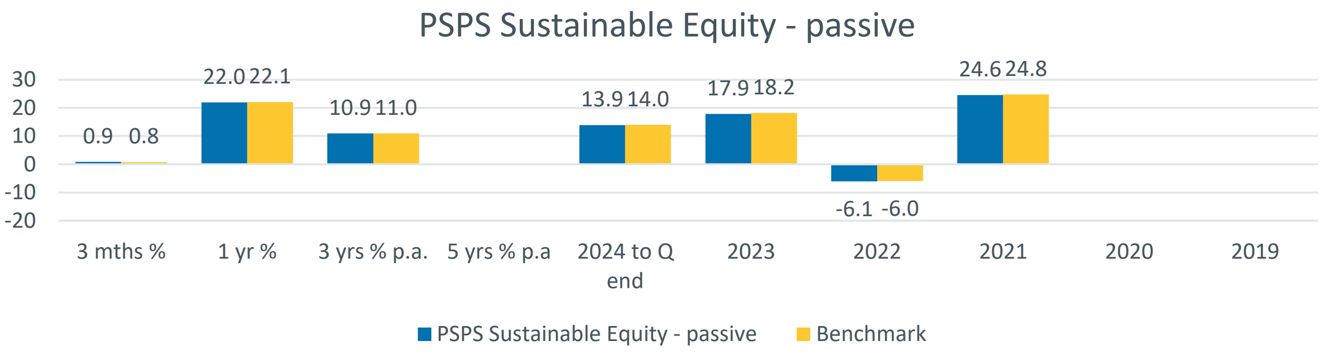


PSPS Index-Linked Gilts - passive

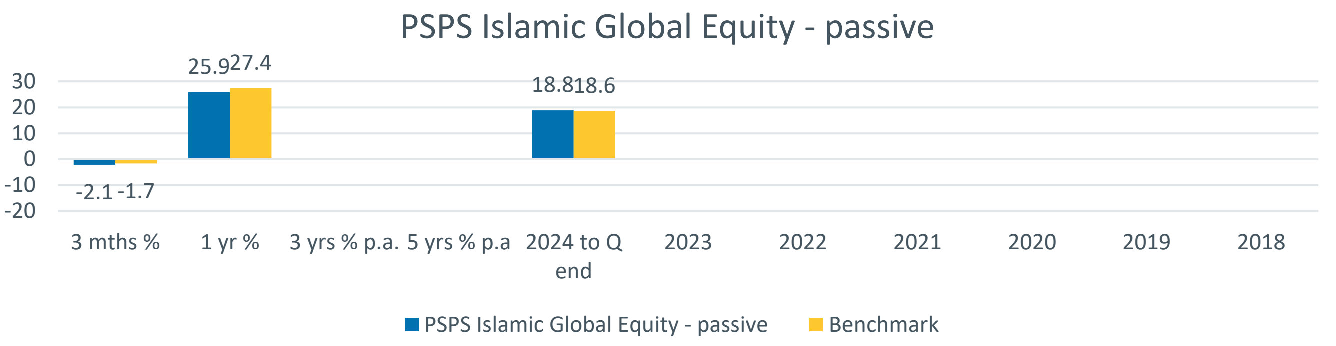


PSPS Long-dated Gilts - passive





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

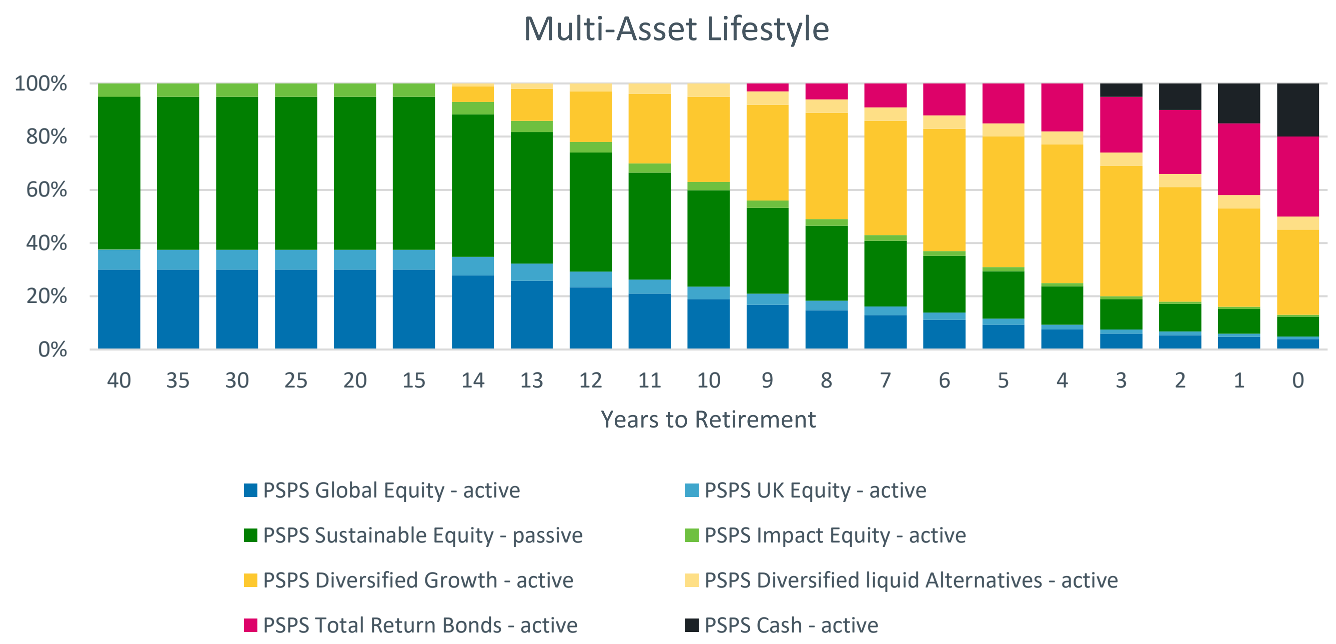


PSPS Islamic Global Equity – passive launched 11th May 2023

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 September 2024

Member - Years to Target Retirement Age	3 Months %	12 Months %	3 Years % p.a.	5 Years % p.a.
30 Years	1.5	20.1	7.3	9.0
10 Years	2.5	17.7	6.0	6.8
3 Years	3.1	14.0	4.8	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.