May 2024

XPS Investment News

Bringing you our market round-up and the latest news affecting UK pension scheme investments

Month in brief

- US inflation rose over March largely due to rising fuel costs as tensions in the Middle East escalated
- Sticky US inflation is having a knock-on impact on other central banks
- Global equity markets cooled in April but UK and Emerging Market equities outperformed
- UK DB pension scheme funding improved thanks to rising gilt yields reducing the value of liabilities

Nkolika Ezepue
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Nkolika's May update

Nagging inflation divides opinion on when interest rate cuts will begin

The Federal Reserve's preferred measure of inflation rose by 0.2% over March as conflict between Iran and Israel escalated, pushing up oil prices in the first quarter, before they fell back over April. US inflation has remained stickier than hoped in 2024 and consensus is now split on when interest rates will start to come down.

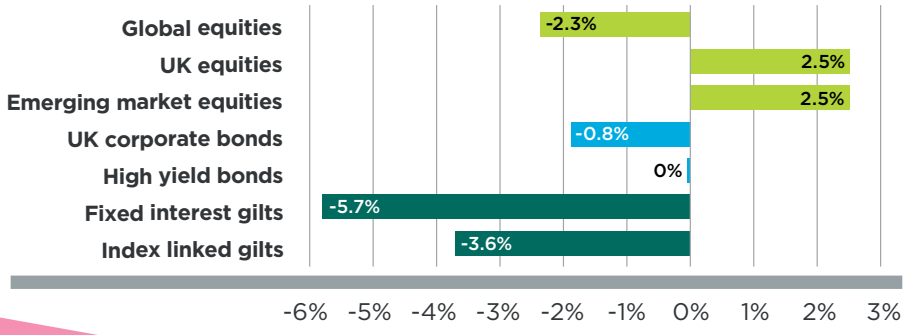
Markets are now suggesting a 1-in-5 possibility of a further increase in US borrowing costs before the end of the year. The most likely path remains at one or two 0.25% Fed rate cuts during the year but this is down substantially from the beginning of the year when investors were optimistic over six cuts taking place during the calendar year.

The Fed's grapple with price pressures is having a knock-on impact on other central banks too. If other regions cut rates more aggressively than the Fed, they run the risk of economic damage from the weakening of their currency relative to the Dollar and potentially reigniting inflationary pressures. European Central Bank (ECB) President Christine Lagarde reaffirmed signals that the ECB will look to cut rates during the summer should energy costs – the main driver of Eurozone inflation – continue to fall.

In the UK, expectations of rate cuts have also been pared back. Some members of the Bank of England's Monetary Policy Committee (MPC), including Chief Economist Huw Pill, remain hawkish about the prospect of rate cuts, preferring to keep rates higher. UK consumer price inflation fell to 3.4% in February but UK gilts fell in value during

Equity performance was mixed and gilts performed poorly as yields rose during the month

One Month to 30 April 2024

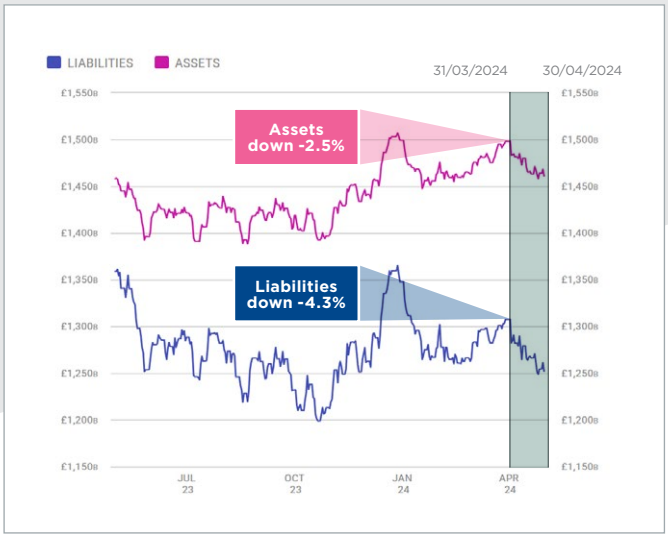


Source: Refinitiv Datastream

April at the prospect of interest rates not falling as quickly as previously thought. Longer term UK inflation expectations also crept up.

The global equity market rally of the first quarter unravelled slightly over April. An escalation of tensions in the Middle East, a stronger Dollar and a cooling-off in the tech stock rally were key contributors. On the other hand, UK equities performed well as the economy shrugged off the technical recession in the second half of 2023, with estimated growth of 0.1% in February following on from 0.3% in January. Emerging markets matched the UK with mainland Chinese and Hong Kong stocks performing well as sentiment on Chinese stocks began to shift.

Aggregate UK DB pension scheme funding on a low risk basis rose over the month. Whilst growth asset performance had been a key driver over Q1, pension scheme funding benefitted from steadily rising gilt yields during April which served to reduce the value of liabilities.



Source: XPS DB:UK www.xpsgroup.com/services/xps-pensions/xps-dbuk-funding-watch

The charts above are based on data from The Pensions Regulator, the PPF 7800 Index and the XPS data pool. The assumptions used in the UK:DB long-term target basis include a discount interest rate of gilt yields plus 0.5%. The assumed asset allocation is 16.9% equities, 20.0% corporate bonds, 6.9% multi-asset, 5.1% property, 3.8% private markets and 47.3% in liability driven investment (LDI) with the LDI overlay providing a 60% hedge on inflation and interest rates.

To discuss any of the issues covered in this edition, please get in touch with Nkolika Ezepue.

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Alternatively, please speak to your usual XPS Investment contact.

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