London Borough of Havering Pension Fund

Q2 2023 Investment Monitoring Report

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HYMANS ROBERTSON

Headlines

- This section outlines the key points included in this report.
- The tactical benchmark in the Fund Performance table represents the aggregate performance target of the Fund's assets and is a measure of relative outperformance / underperformance from the asset managers.
- The strategic benchmark represents the expected rate at which the Fund's liabilities are growing (or falling) in value. The asset performance relative to the strategic benchmark performance gives an indication of whether the funding level has improved or weakened over a given period.

Key Takeaways

Equity and credit assets performed well.	• Global growth remained strong due to continued resilience in labour markets and consumer spending. • All developed equity mandates performed positively in absolute terms. • The LCIV Global Alpha Growth Paris Aligned Fund underperformed due to relative sector positioning, when technology stocks outperformed. • The LCIV Absolute Return Fund and LCV DGF performed negatively in both absolute and relative terms, as expected in a more 'risk on' environment.
Real gilt yields rose sharply.	• As core inflation rose and central banks continued to announce interest rate hikes, real gilt yields rose sharply – negatively impacting the valuation and performance of the IL gilt mandate • The value of the Fund's liabilities are also expected to have fallen in value due to the increase in gilt yields, as proxied by the return of the strategic benchmark
Overall fund performance was positive as the total Fund value increased by around 0.2%, significantly outperforming the strategic benchmark.	• The Fund's performance of 0.2% was behind the tactical benchmark of 1.9%. • Fund performance remains comfortably ahead of the strategic benchmark (the proxy assumed growth of liabilities) over longer time periods. • The outperformance of the assets relative to the strategic benchmark over all time periods considered indicates the funding level of the Fund (ratio of assets to liabilities) has improved significantly in recent times
USD and EUR denominated assets were negatively impacted as GBP appreciated, but the currency hedging programme offset this	• Many of the Fund's private market assets have either USD or EUR exposure. As a result, they demonstrated a weaker return when converted to GBP. However, currency hedging largely offset this.
Large negative relative returns were observed across some of the Fund's real asset and private debt mandates, but there are no immediate concerns	• Most of these mandates are measured against inflation and 'cash plus' based benchmarks. Year on year core inflation and interest rates remain high with asset returns not having kept pace over the short term • Overall property capital value declines have started to stabilise but values across the office sector continue to decline.

Fund Performance

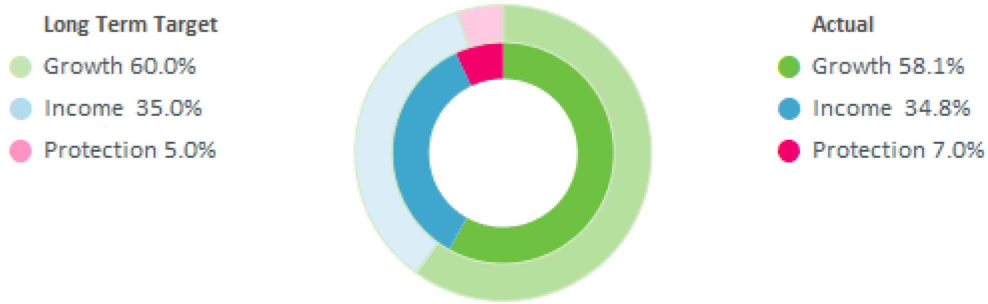
	Last 3 months (%)	Last 12 months (%)	Last 3 years (%)	Last 5 years (%)
Total Fund Performance	**0.2**	**2.7**	**4.3**	**4.7**
Tactical Benchmark	1.9	6.3	6.3	6.0
Strategic Benchmark	-5.7	-14.4	-10.6	-2.4

Fund Asset Valuation

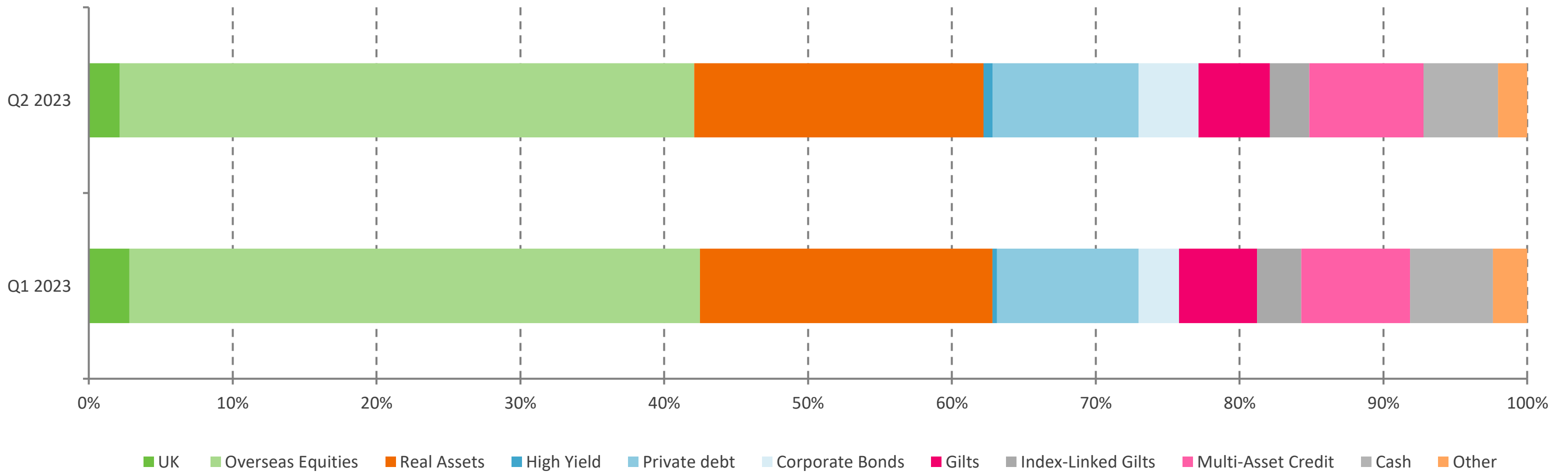
	Fund value (£m)
Q1 2023	**894.1**
Q2 2023	**905.0**

- The Fund's investment strategy is implemented through the London Collective Investment Vehicle ("LCIV"), and retained assets including life funds (with fee structures aligned with LCIV).
- The target allocation to LCIV and life funds totals 62.5% of Fund assets. Other retained assets will be delivered through external managers, with the position reviewed periodically.
- The chart below right illustrates the underlying asset allocation of the Fund, i.e. taking account of the underlying holdings in the multi-asset funds on a 'look through' basis.
- The Fund's overall allocation to equities marginally decreased over the quarter to c.42.1% (c.42.5% as at 31 March 2023) – this was due to the LCIV Absolute Return Fund's equity allocation decreasing from 22.7% to 15.5%. However, the Fund's overall allocation to equities increased (in GBP terms) as global equities rose over the quarter.
- The allocation to gilts fell to c.5.0% (c.5.4% as at 31 March 2023) – this was due to the LCIV Absolute Return Fund's allocation to fixed income inflation linked bonds increasing from 21.5% to 34.5%. Similarly, the allocation to corporate bonds increased to c.4.2% (c.2.8% as at 31 March 2023) – this was due to the LCIV Absolute Return Fund's allocation to fixed income nominal government bonds decreasing from 29.7% to 26.6%.
- The allocation to multi-asset credit increased to c.7.9% (c.7.6% as at 31 March 2023 – this was due to the LCIV Diversified Growth Fund increasing its allocation to investment grade and insurance linked securities over the quarter, from c.2.5% and c.3.5% to c.6.0% and c.5.1%, respectively.
- The allocations to real assets, private debt and high yield assets remained relatively unchanged over the quarter.

Asset Allocation



Asset Class Exposures



- The Fund's assets returned 0.2% over the quarter, underperforming its 1.9% benchmark return.
- The majority of equity mandates delivered positive returns as developed global equities rose over the quarter.
- The LCIV Absolute Return Fund continued to drag absolute and relative returns as the fund remains protectively positioned (i.e. providing protection against downside risk, rather than focussing on asset growth). Therefore, as higher risk asset classes such as equities continued to perform positively, the fund struggled.
- Similarly, the LCIV DGF dragged absolute and relative returns also as the fund's equity exposure had reduced from 21.5% as at 31 March 2023 to 13.3% as at 30 June 2023. Allocations to developed market government and corporate bonds also contributed negatively, as real gilt yields rose and offset the tightening of investment grade credit spreads over the period.
- As capital values stabilised over the quarter, there were mixed returns across the Fund's real assets in absolute terms. However, the majority of real assets underperformed their respective 'cash plus' benchmarks. Of the property funds (UBS and CBRE) both have sector allocations of 13.1% and 15.5%, respectively, to offices where capital values have continued to decline over the period.
- The RLAM Index Linked Gilts mandate delivered negative absolute returns as real gilt yields rose sharply over the second quarter of 2023 – with higher inflation and interest expectations over the medium term.
- Please note that all asset performance is in GBP terms and does not make an allowance for currency fluctuations. The total Fund performance includes the impact of the Russell currency overlay mandate. Please note the separate slide for further detail on the Russell mandate, along with asset performance excluding the impact of currency fluctuations.

Manager Performance

	Actual Proportion	Last 3 months (%)			Last 12 months (%)			Last 3 years (% p.a.)			Since Inception (% p.a.)		
		Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative	Fund	B'mark	Relative
Growth	**58%**												
LGIM Global Equity	*4.0%*	3.3	3.4	**0.0**	11.6	11.7	**-0.1**	10.3	10.4	**-0.1**	11.4	11.4	**0.0**
LGIM Emerging Markets	*3.9%*	-1.9	-1.9	**0.0**	-3.4	-3.2	**-0.2**	2.3	2.6	**-0.2**	3.2	3.4	**-0.2**
LGIM Future World Fund	*10.5%*	1.9	1.9	**0.0**	9.3	9.5	**-0.1**	-	-	-	1.2	1.3	**-0.1**
LCIV Global Alpha Growth Paris Aligned Fund	*15.5%*	3.2	3.9	**-0.7**	11.0	13.2	**-2.0**	2.9	11.0	**-7.3**	12.1	11.7	**0.3**
LCIV PEPPA Passive Equity	*5.1%*	5.2	4.9	**0.3**	17.1	14.9	**2.0**	-	-	-	-0.3	-1.6	**1.4**
LCIV Absolute Return Fund	*12.0%*	-6.6	2.1	**-8.5**	-1.2	7.2	**-7.8**	4.8	5.2	**-0.4**	4.6	5.0	**-0.3**
LCIV Diversified Growth Fund	*7.2%*	-2.1	2.0	**-4.0**	-1.8	6.9	**-8.1**	0.3	4.8	**-4.3**	2.3	4.3	**-1.9**
Income	**35%**												
UBS Property	*5.7%*	0.8	0.4	**0.4**	-17.5	-17.4	**-0.2**	4.2	3.4	**0.8**	5.4	5.9	**-0.5**
CBRE	*3.7%*	-3.0	3.2	**-6.0**	-6.6	12.9	**-17.3**	5.5	11.6	**-5.5**	6.9	9.6	**-2.5**
JP Morgan	*4.1%*	-0.4	3.2	**-3.5**	1.7	12.9	**-9.9**	6.8	11.6	**-4.3**	8.2	9.6	**-1.2**
Stafford Capital Global Infrastructure SISF II	*4.1%*	-2.3	3.2	**-5.4**	9.0	12.9	**-3.5**	6.9	11.6	**-4.2**	8.0	9.4	**-1.2**
Stafford Capital Global Infrastructure SISF IV		3.0	3.2	**-0.2**	6.1	12.9	**-6.0**	-	-	-	17.3	12.1	**4.6**
LCIV Renewable Energy Infrastructure Fund	*1.4%*	-1.1	3.2	**-4.1**	36.7	12.9	**21.1**	-	-	-	17.3	13.6	**3.2**
RLAM Multi-Asset Credit	*6.7%*	1.1	1.9	**-0.8**	6.8	8.3	**-1.4**	0.7	1.2	**-0.5**	6.5	6.2	**0.3**
Churchill Senior Loan Fund II	*2.3%*	-0.5	2.1	**-2.5**	1.9	7.2	**-5.0**	5.5	5.2	**0.3**	5.5	5.1	**0.4**
Churchill Senior Loan Fund IV	*1.8%*	-0.6	2.1	**-2.6**	0.3	7.2	**-6.4**	-	-	-	8.9	6.3	**2.4**
Permira IV	*5.0%*	2.0	2.1	**0.0**	6.8	7.2	**-0.4**	5.3	5.2	**0.1**	4.4	5.2	**-0.7**
Permira V		2.4	2.1	**0.3**	5.3	7.2	**-1.8**	-	-	-	5.3	7.2	**-1.8**
Protection	**7%***												
RLAM Index Linked Gilts	*2.7%*	-9.8	-7.8	**-2.2**	-23.3	-20.0	**-4.2**	-16.3	-14.8	**-1.7**	-12.2	-10.8	**-1.6**
Total		0.2	1.9	**-1.6**	2.7	6.3	**-3.4**	4.3	6.3	**-1.9**	7.7	-	-

Source: Northern Trust, investment managers. Please note that benchmark performance for Baillie Gifford DGF and Ruffer Absolute Return funds is inclusive of outperformance targets. In addition, longer term performance for Baillie Gifford Global Equity, Baillie Gifford DGF and Ruffer Absolute Return funds is inclusive of performance prior to their transfer into the London CIV. LGIM Global and Fundamental Equity mandates were managed by SSGA prior to November 2017 and we have retained the performance history for these allocations. Performance figures for CBRE, Stafford and JP Morgan has been taken from the managers rather than Northern Trust. The Fund performance figure includes the effect of the currency hedging mandate managed by Russell.

**Includes cash at bank and currency hedging*

Current Investment Implementation

The total value of the Fund's assets increased by £10.9m over the quarter to £905.0m as at 30 June 2023.

The increase in valuation can be primarily attributed to the Fund's allocation to equities, followed by the Fund's allocation to infrastructure. Due to corporate earnings outperforming expectations and optimism in the technology sector, global equities continued to rise over the quarter.

Following high core inflation and continued increases in interest rates, real gilt yields rose over the quarter and a result the Fund's RLAM Index linked Gilts mandate decreased in value.

Global sub-investment grade credit spreads tightened 0.5% p.a. to 4.5% p.a. over the quarter, positively impacting the RLAM MAC mandate.

The Fund's real assets were relatively unchanged as capital values stabilised over the quarter. In property, capital values in the office sector however continued to decline.

The Fund's allocation to its multi-asset mandates, specifically the LCIV Absolute Return Fund, continued to fall in value over the quarter. This remained due to defensive positioning, when wider equity and bond market sentiments continued to improve over 2023.

The Fund paid the following capital calls during the quarter:

- c.£2.0m overall to the LCIV Renewable Energy Infrastructure Fund.
- c.£1.5m to the Churchill Fund IV.

Please see further details regarding the Fund's movement towards its 'Interim' investment strategy in our "LCIV Global Bond Fund Recommendation Note" and our previous investment strategy papers.

Asset Allocation

Manager	Pooling	Valuation (£m) Q1 2023	Valuation (£m) Q2 2023	Actual Proportion	Benchmark	Relative
Growth		**526.2**	**526.0**	**58.1%**	**60.0%**	**-1.9%**
LGIM Global Equity	LCIV aligned	34.6	35.8	4.0%	5.0%	-1.0%
LGIM Emerging Markets	LCIV aligned	36.2	35.5	3.9%	5.0%	-1.1%
LGIM Future World Fund	LCIV aligned	93.4	95.2	10.5%	10.0%	0.5%
LCIV Global Alpha Growth Paris Aligned Fund	LCIV	135.6	139.9	15.5%	15.0%	0.5%
LCIV PEPPA Passive Equity	LCIV	44.0	46.3	5.1%	5.0%	0.1%
LCIV Absolute Return Fund	LCIV	115.9	108.3	12.0%	12.5%	-0.5%
LCIV Diversified Growth Fund	LCIV	66.5	65.1	7.2%	7.5%	-0.3%
Income		**311.9**	**315.3**	**34.8%**	**35.0%**	**-0.2%**
UBS Property	Not pooled	51.1	51.2	5.7%	6.0%	-0.3%
CBRE	Not pooled	34.7	33.6	3.7%	4.0%	-0.3%
JP Morgan	Other pooled	37.0	37.0	4.1%	4.0%	0.1%
Stafford Capital Global Infrastructure SISF II	Not pooled	19.9	19.3	4.1%	3.5%	0.6%
Stafford Capital Global Infrastructure SISF IV	Not pooled	16.4	17.5			
LCIV Renewable Energy Infrastructure Fund	Not pooled	11.2	13.0	1.4%	2.5%	-1.1%
RLAM Multi-Asset Credit	Not pooled	60.4	61.1	6.7%	7.5%	-0.8%
Churchill Senior Loan Fund II	Other pooled	21.8	21.0	2.3%	3.0%	-0.7%
Churchill Senior Loan Fund IV	Other pooled	15.3	16.3	1.8%		
Permira IV	Other pooled	31.0	31.1	5.0%	4.5%	0.5%
Permira V	Other pooled	13.2	14.4			
Protection		**55.9**	**63.6**	**7.0%**	**5.0%**	**2.0%**
RLAM Index Linked Gilts	Not pooled	27.3	24.6	2.7%	5.0%	-2.3%
Cash at Bank	n/a	22.8	29.1	3.2%	0.0%	3.2%
Currency Hedging P/L	Not pooled	5.9	9.9	1.1%	0.0%	1.1%
Total Fund		**894.1**	**905.0**	**100.0%**	**100.0%**	

Pooling refers to whether the holding benefits from some form of collective bargaining. LCIV and LCIV aligned reflect mandates aligned with or managed by the LCIV. Other pooled indicates mandates where there are collective LGPS fee arrangements in place. Not pooled indicates mandates outside pooling arrangements.

Source: Northern Trust, Investment Managers

LGIM Global Equity Fund

- The objective of this fund is to match the performance of the benchmark FTSE All World Index.

LGIM Emerging Markets Fund

- The objective of this fund is to match the performance of the benchmark FTSE Emerging Markets Index.

LGIM Future World Fund

- The objective of this fund is to match the performance of the benchmark FTSE All World ex. Controversial Weapons Climate Balanced Factor Index.

Over the quarter, longer time periods of 1 year and 3 years and since inception, all LGIM equity funds have performed broadly in line with their respective benchmark indices.

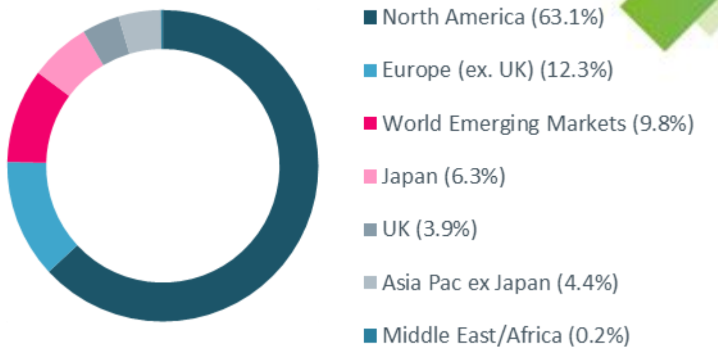
Both the Global Equity and Future World funds returned positively over the quarter due to their significant allocations to the technology sector – 24.0% and 20.6%, respectively. The performance was driven by the increasing interest in artificial intelligence as well as strong performance from 'mega-cap' technology stocks such as Apple, Microsoft, Amazon etc.

The Emerging Markets fund returned negatively over the quarter due to its large regional allocation to China, 32.8%. Emerging market performance lagged over the second quarter, with the slower than expected, post-Covid, economic recovery from China driving underperformance.

LGIM Global Equity

	Last 3 months (%)	Last 12 months (%)	Last 3 years (% p.a.)	Since Inception (% p.a.)
LGIM Global Equity	3.3	11.6	10.3	11.4
Benchmark	3.4	11.7	10.4	11.4
Relative	0.0	-0.1	-0.1	0.0

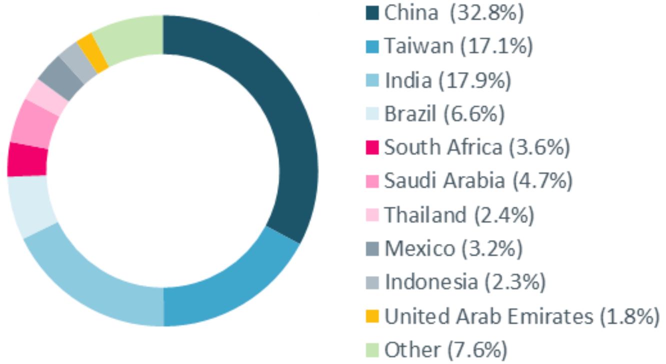
Region allocation



LGIM Emerging Markets

	Last 3 months (%)	Last 12 months (%)	Last 3 years (% p.a.)	Since Inception (% p.a.)
LGIM Emerging Markets	-1.9	-3.4	2.3	3.2
Benchmark	-1.9	-3.2	2.6	3.4
Relative	0.0	-0.2	-	-0.2

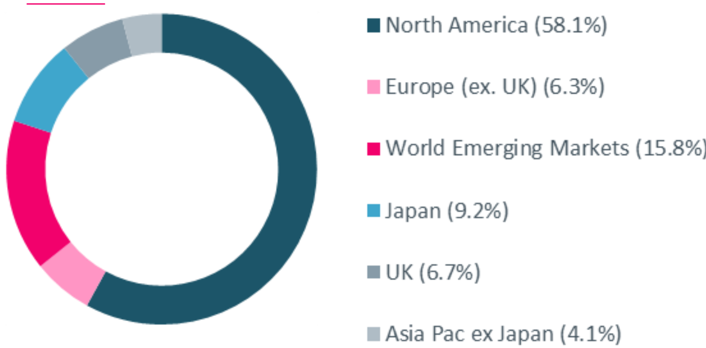
County Allocation



LGIM Future World

	Last 3 months (%)	Last 12 months (%)	Since Inception (% p.a.)
LGIM Future World Fund	1.9	9.3	1.2
Benchmark	1.9	9.5	1.3
Relative	0.0	-	-0.1

Region allocation



Source: Investment Managers, LCIV, Northern Trust.

Manager Analysis

- The Fund accesses global equity sub-funds through LCIV. LCIV are responsible for the ongoing monitoring and governance of any underlying investment managers.

LCIV Global Alpha Growth Paris Aligned Fund

- The sub-fund's objective is to match the performance of the MSCI ACWI Index + 2% p.a..
- The sub-fund returned positively over the quarter due to allocations to consumer discretionary and technology sectors, 20.9% and 16.4%, respectively. Both of which performed positively over the quarter. However, the sub-fund's relative underweight to the technology sector in comparison to its benchmark index, resulted in slight underperformance over the period.
- Over the longer period of 1 year and 3 years, the sub-fund underperforms its benchmark. However, since inception the sub-fund marginally outperforms its benchmark.

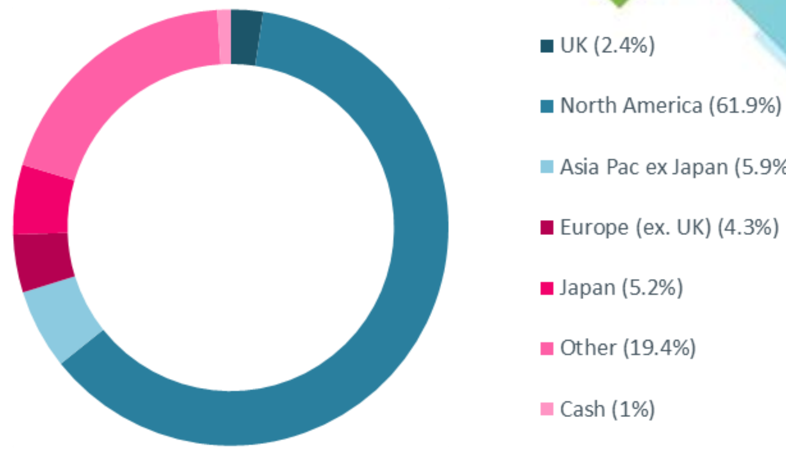
LCIV Passive Equity Progressive Paris Aligned Fund

- The sub-fund's objective is to match the performance of the S&P Developed Ex-Korea Large Mid Cap Net Zero 2050 Paris-Aligned ESG Index.
- The sub-fund returned positively over the quarter, again, due to allocations to technology and consumer discretionary sectors, 23.6% and 11.1% respectively.
- As a passive sub-fund, regional and sectoral allocations were in line with the benchmark index, with little divergence, and as such, the sub-fund performed broadly in line with the benchmark index over all time periods.

LCIV Global Alpha Paris Aligned

	Last 3 months (%)	Last 12 months (%)	Last 3 years (% p.a.)	Since Inception (% p.a.)
LCIV Global Alpha Paris	3.2	11.0	2.9	12.1
Benchmark	3.9	13.2	11.0	11.7
Relative	-0.7	-2.0	-7.3	0.3

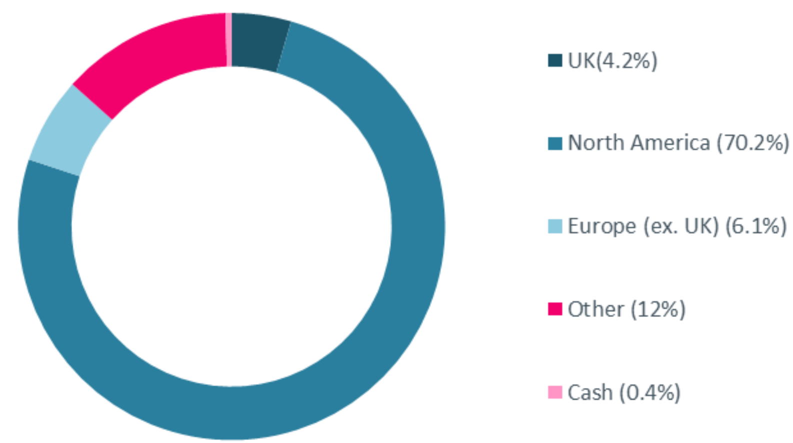
Country Weights



LCIV PEPPA Passive Equity

	Last 3 months (%)	Last 12 months (%)	Since Inception (% p.a.)
LCIV PEPPA Passive Equity	5.2	17.1	-0.3
Benchmark	4.9	14.9	-1.6
Relative	0.2	2.0	1.4

Country Weights



Source: Investment Managers, LCIV, Northern Trust.

Russell Currency Hedging

- Russell Investments have been appointed to manage the Fund's currency overlay mandate.
- The current policy is to hedge non-sterling exposures in the Fund's private markets mandates. Currency exposure in equity mandates is retained.
- At present, 100% of the exposure to USD, EUR and AUD from the private market investments is hedged within any residual currency exposure retained on a de-minimis basis.
- The volatility of returns (measured as the standard deviation of quarterly returns since inception) is 5.0% to date when the impact of currency fluctuations is included and only 4.5% when currency movements are stripped out by the Russell currency overlay mandate. This continues to indicate that the Russell mandate is reducing overall volatility and increasing the predictability of returns, as intended.

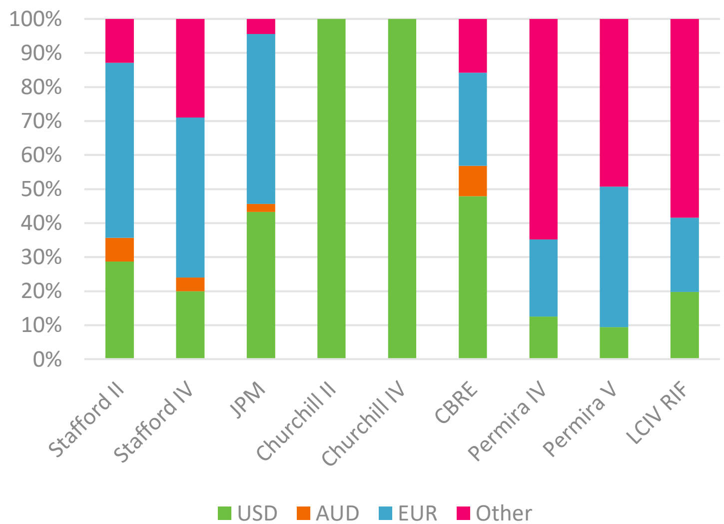
Q2 2023 Performance

	Asset Return (inc. FX impact)	Currency Return (via Russell mandate)	Asset Return (ex. FX impact)	BM Return	Relative Return (ex. FX impact)
Stafford II	-2.3	2.3	0.0	3.2	-3.1
Stafford IV	3.0	1.8	4.7	3.2	1.5
JPM	-0.4	2.5	2.2	3.2	-1.0
Churchill II	-0.5	2.5	2.0	2.1	0.0
Churchill IV	-0.6	2.4	1.8	2.1	-0.2
CBRE	-3.0	2.3	-0.7	3.2	-3.8
Permira IV	2.0	1.7	3.8	2.1	1.7
Permira V	2.4	1.8	4.2	2.1	2.1
LCIV RIF	-1.1	1.0	-0.1	3.2	-3.2

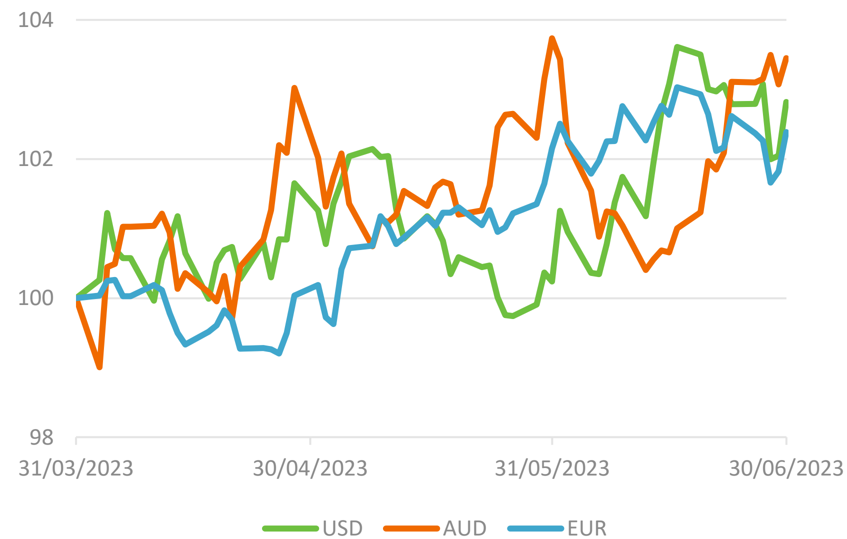
Performance Since Mandate Inception*

	Asset Return (inc. FX impact)	Currency Return (via Russell mandate)	Asset Return (ex. FX impact)	BM Return	Relative Return (ex. FX impact)
Stafford II	8.7	-0.4	8.3	9.4	-1.0
Stafford IV	19.4	-1.6	17.8	12.1	5.1
JPM	9.4	-0.8	8.6	9.6	-0.8
Churchill II	6.8	-2.0	4.8	5.1	-0.3
Churchill IV	8.9	-4.3	4.6	6.3	-1.6
CBRE	7.2	-0.6	6.6	9.6	-2.7
Permira IV	4.4	0.1	4.6	5.2	-0.6
Permira V	5.3	-2.1	3.2	7.2	-3.7
LCIV RIF	17.3	-0.8	16.5	13.6	2.5

Hedged Currency Exposure **



Sterling Performance vs. Foreign Currencies (Rebased to 100 at 31 March 2023)



Source: Northern Trust, Investment managers
**Since inception performance is since individual fund inception of inception of the currency hedging mandate, whichever is more recent. ** As at 31 March 2023 (latest available).*

Private Markets Investments

- Since March 2018, the Fund has made commitments to seven private markets funds as outlined right. The table provides a summary of the commitments and drawdowns to 31 March 2023.
- The outstanding commitments to the remaining funds will be funded from the LCIV Diversified Growth Fund, other overweight positions alongside capital being returned from other mandates.

Mandate	Infrastructure			Private Debt		
Vehicle	**Stafford Infrastructure Secondaries Fund II**	**Stafford Infrastructure Secondaries Fund IV**	**LCIV Renewable Energy Infrastructure Fund**	**Churchill Middle Market Senior Loan Fund IV**	**Permira Credit Solutions IV Senior Fund**	**Permira Credit Solutions V Senior Fund**
Commitment Date	25/04/2018	18/12/2020	30/06/2021	29/09/2021	12/2018	07/11/2022
Fund Currency	EUR	EUR	GBP	USD	EUR	EUR
Gross Commitment	€28.5m	€30m	£25m	$26.5m	£36.0m	£43.0m
Gross Commitment (GBP estimate)	£24.5m	£25.7m	-	£20.8m	-	-
Capital Called During Quarter (Payments Less Returned Capital)	-	-	£2.0m	£1.5m	-	-
Capital Drawn To Date	£26.3m	£15.4m	£9.8m	£17.2m	£31.1m	£12.7m
Distributions/Returned Capital To Date (Includes Income and Other Gains)	£13.4m	£0.9m	-	£1.6m	£4.9m	£0.2m
NAV at Quarter End	£19.3m	£17.5m	£13.0m	£16.3m	£31.1m	£14.4m
Net IRR Since Inception *	8.8% p.a. (v. 8-9% target)	17.4%	-	5.8%**	7.9%	23.4%
Net Cash Yield Since Inception*	7.4% p.a. (v. 5% target)	5.3%	-	-	-	-
Number of Holdings*	22 funds	17 funds	-	131 investments	83 investments	31 investments

**as at 31 March 2023 (latest available) **Refers to IRR of realised assets in the portfolio*

Source: Investment Managers

Consensus forecasts for 2023 global GDP growth saw further upwards revisions in Q2, given unexpected resilience in labour markets and consumer spending. Nonetheless, with higher interest rates likely to weigh on consumer and business activity in the second half of 2023 and into 2024, growth forecasts remain relatively weak.

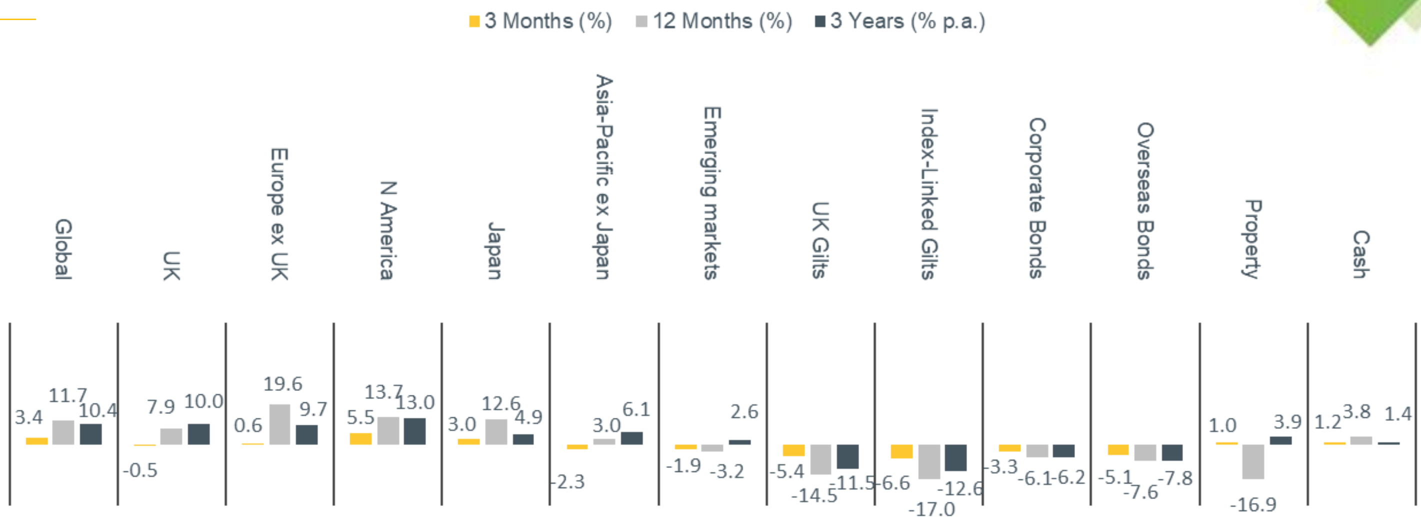
UK inflation data released during Q2 came in higher than forecasters expected. However, June's UK headline CPI inflation figure, released in July, fell more than expected, to 7.9% year-on-year and core inflation slipped back to 6.9% from 7.1%. Equivalent CPI inflation in the US and Eurozone fell to 3.0% and 5.5%, respectively, in June, and core inflation eased to 4.8% in the US, but rose to 5.5% in the Eurozone.

Responding to a run of higher-than-expected inflation, the Bank of England (BoE) raised rates by 0.75% p.a. in Q2, to 5.0% p.a., including a surprise 0.5% p.a. increase in June. The US Federal Reserve raised rates by 0.25% p.a., to 5.25% p.a., in May; pausing in June to evaluate the impact of prior tightening. The European Central Bank increased their deposit rate 3.5% p.a.

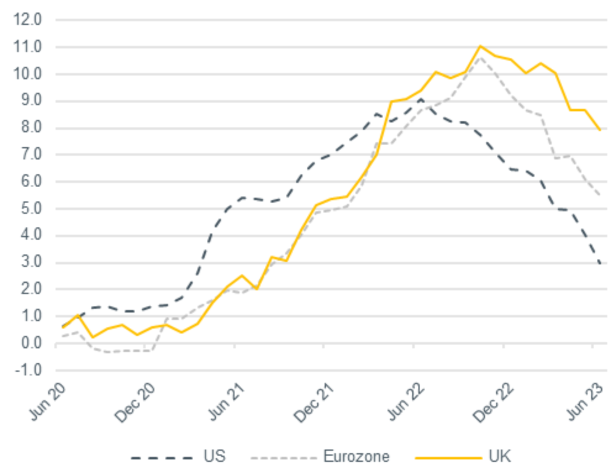
UK 10-year implied inflation, as measured by the difference between conventional and inflation-linked bonds of the same maturity, was unchanged at 3.6% p.a., as real and nominal yields rose by similar amounts.

UK gilt yields surged as disappointing inflation data was compounded by heavy issuance and BoE gilt sales. UK 10-year gilt yields rose sharply by 0.8% p.a. to 4.4% p.a., while US yields rose 0.2% p.a. to 3.8% p.a., and equivalent German yields rose 0.1% p.a., to 2.4% p.a.

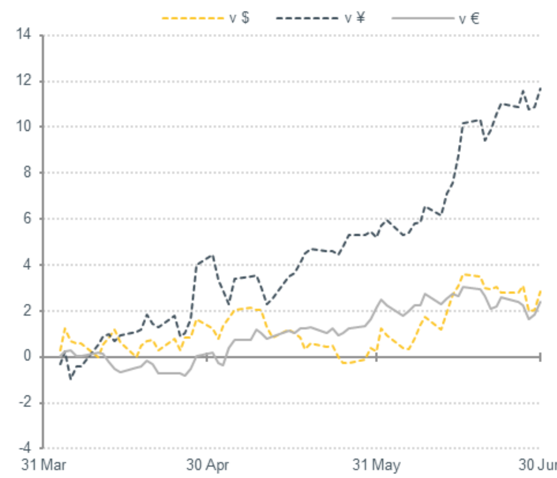
Historic returns for world markets [1]



Annual CPI Inflation (% p.a.)



Sterling trend chart (% change)



Source: DataStream. [1] Returns shown in Sterling terms. Indices shown (from left to right) are: FTSE All World, FTSE All Share, FTSE AW Developed Europe ex-UK, FTSE North America, FTSE Japan, FTSE AW Developed Asia Pacific ex-Japan, FTSE Emerging, FTSE Fixed Gilts All Stocks, FTSE Index-Linked Gilts All Maturities, iBoxx Corporates All Investment Grade All Maturities, ICE BofA Global Government Index, MSCI UK Monthly Property; UK Interbank 7 Day

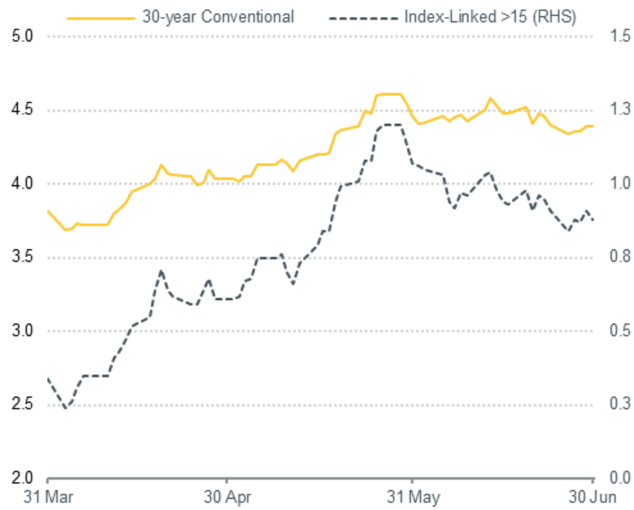
The UK investment-grade credit market recorded negative total returns as the rise in underlying gilt yields more than offset a fall in credit spreads. Global investment-grade credit spreads decreased by 0.1% p.a. to 1.4% p.a., and global speculative-grade credit spreads decreased by 0.5% p.a. to 4.5% p.a.

The FTSE All World Total Return Index rose 6.7%, buoyed by better-than-expected earnings and AI-inspired optimism around the technology sector. Japanese and North American equities outperformed, with the exporter-heavy index of the former benefitting from Yen weakness and the latter benefitting from its disproportionately high exposure to the technology sector. Disappointing Chinese activity data dragged down emerging markets and Asia Pacific ex-Japan. The UK was the worst performing region, as the basic materials and energy sectors underperformed amid commodity price declines and global manufacturing weakness.

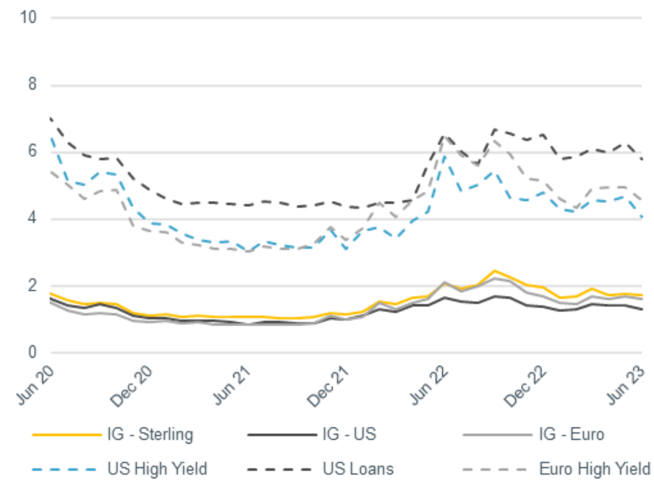
Sterling rose over 4.0% in trade-weighted terms as interest rate expectations soared. Meanwhile, equivalent US and euro measures rose 0.8% and 2.1%, respectively, while the yen measure fell more than 5%. The S&P GSCI Commodity Spot Price Index fell 5.8% in Q2, driven by declines in energy and industrial metal price.

UK commercial property values, as measured by the MSCI UK Property Index, had fallen by over 21% in the 12 months to end-June. Capital values have somewhat stabilised in recent months, though office values continued to decline in June. Alongside income, this led to a modest positive total return from the market over the quarter.

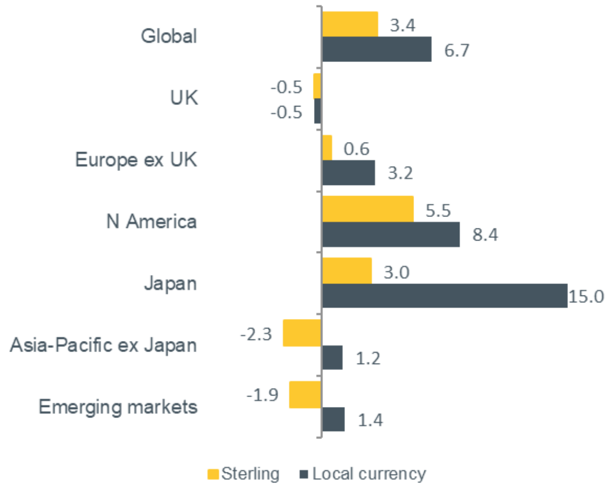
Gilt yields chart (% p.a.)



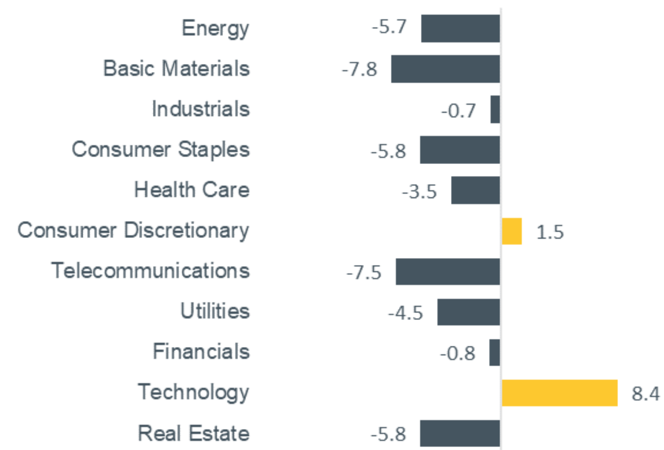
Investment and speculative grade credit spreads (% p.a.)



Regional equity returns [1]



Global equity sector returns (%) [2]



Source: DataStream, Barings, ICE [1] FTSE All World Indices. Commentary compares regional equity returns in local currency. [2] Returns shown in Sterling terms and relative to FTSE All World.

HYMANS ROBERTSON

Capital Markets Outlook

Asset Class	Market Summary
Equities	• Despite consensus global corporate earnings growth expectations for full-year 2023 sitting at a lacklustre 0.7%, they may still be vulnerable to disappointment should economic growth slow as we expect. Recent price performance has taken cyclically adjusted valuations further above long-term averages, leaving limited scope for revaluation to drive equities higher against a challenging fundamental backdrop. Furthermore, recent rises in real yields leave equities looking very expensive relative to risk-free assets.
Investment Grade Credit	• Debt affordability metrics are expected to come under pressure, but corporate balance sheets start from a strong position. Though speculative-grade default rates are expected to peak at lower levels than in previous slowdowns, we retain a preference for investment-grade markets, where the deterioration in fundamentals is expected to be less severe and take longer to materialise than in speculative-grade markets.
Emerging Market Debt	• Given an earlier and sharper tightening of monetary policy, several EM regions have positive real policy rates and inflation is declining, albeit from elevated levels. This provides a relatively supportive backdrop for local currency yields, which remain above our assessment of longer-term fair value. A weak growth outlook, disappointing Chinese economic data, and commodity price declines make for a more challenging fundamental backdrop for hard currency debt. However, index-level spreads are well above long-term median levels.
Liquid Sub-Investment Grade Debt	• Default rates have started to rise with the loan market leading the cycle given the rapid increase in lower-rated, loan only capital structures in recent years. Global high-yield bond spreads, below long-term medians, offer little compensation against downside risks and though loan spreads are higher relative to history, this largely reflects greater fundamental risks in the loan market.
Private Lending	• Manager's underwriting has become more conservative as debt affordability is expected to come under pressure from rising borrowing costs and weaker earnings. Leverage levels on new deals has fallen as a result. Defaults are rising but given a greater proportion of non-cyclical origination may peak at lower levels than the traded loan market. Valuations are attractive relative to the new issue traded loan market, which is now functioning again.
Core UK Property	• Although yields have risen sharply over the last year, they remain low versus history, and do not yet reflect adequate compensation for the risks. Furthermore, the yield premium on commercial property versus gilts suggests property looks increasingly expensive relative to risk-free assets. While capital values have stabilised in recent months, transaction volumes are low, and the economic backdrop and higher interest rates could easily force more sellers to market.
Conventional Gilts	• Even allowing for elevated near-term inflation, slightly higher inflation over the medium term, and the uncertainty associated with that outlook, 10-year nominal gilt yields of 4.6% pa look attractive versus our assessment of fair value of around 3.5% pa. We see the best value in gilt yields at maturities out to 20 years, given a sharp fall in longer-term forward real and nominal yields beyond. However, quantitative tightening and heavy issuance make for a very fragile technical backdrop.
Index-Linked Gilts	• Ten-year index-linked gilt yields have also risen to reasonably attractive levels of 1.1% pa. Very weak real growth forecasts and sticky inflation should help keep a lid on real yields. Gilt-implied inflation, as measured by the difference between nominal and index-linked yields of the same maturity, indicates short-dated index-linked gilts offer decent value but suggests a relative preference for nominal gilts at medium-to-longer terms.

The table summarises our broad views on the outlook for markets. The ratings used are Positive, Attractive, Neutral, Cautious and Negative. The ratings are intended to give a guide to our views on the prospects for markets over a period of around three years; although they are updated quarterly, they are not intended as tactical calls. The ratings reflect our expectations of absolute returns and assume no constraints on investment discretion. In practice, they need to be interpreted in the context of the strategic framework within which individual schemes are managed.

Source: Hymans Robertson

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, investment 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 investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

Hymans Robertson LLP and our group companies have a wide range of clients some of which are fund managers, who may be parties in our recommendations to you in various circumstances including but not limited to manager selection, moving money to or from a manager or supporting retention of or disinvestment from a manager. We have a research team that advises on shortlisting fund managers in manager selection exercises and forming views on managers, which is separate from our client and other relationships with fund managers and therefore we do not believe there will be a conflict that would influence the advice given.

Geometric vs. Arithmetic Performance

Hymans Robertson are among the investment professionals who calculate relative performance geometrically as follows:

$$\frac{(1 + Fund\ Performance)}{(1 + Benchmark\ Performance)} - 1$$

Some industry practitioners use the simpler arithmetic method as follows:

$$Fund\ Performance\ - Benchmark\ Performance$$

The geometric return is a better measure of investment performance when compared to the arithmetic return, to account for potential volatility of returns.

The difference between the arithmetic mean return and the geometric mean return increases as the volatility increases.