AGENDA ITEM 9

PENSIONS PARTNERSHIP

Border to Coast Pensions Partnership Limited

Joint Committee

Date of Meeting: **20 June 2024**

Report Title: **Market Review**

Report Sponsor: **Joe McDonnell (CIO)**

1 Executive Summary

1.1 This report provides an overview of the macroeconomic and market environment and the medium-term investment outlook.

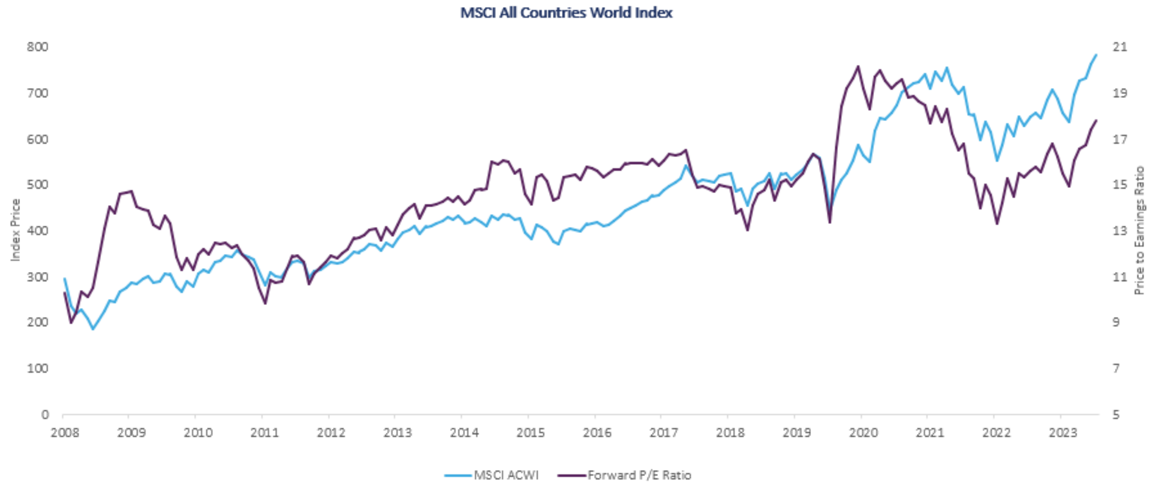
2 Recommendations

2.1 That the report is noted.

3 Markets & Macroeconomic environment

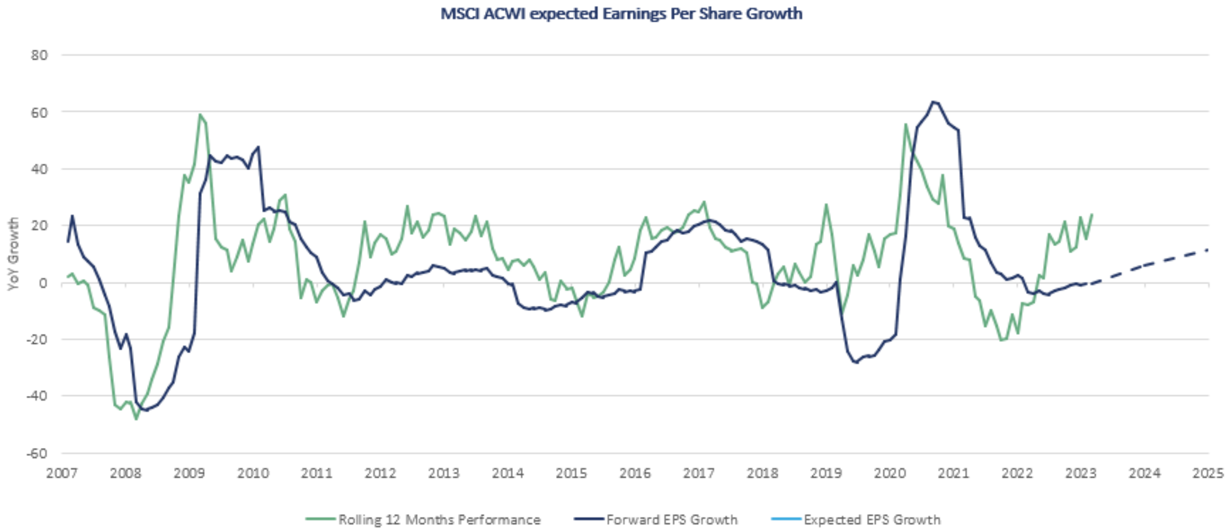
3.1 Resilient economic data in Q1 confirmed the US economy grew by more than expected during Q4 2023, while survey data from the composite Purchasing Managers Index (PMI) remained firmly in expansionary territory, boosting investor sentiment. Macroeconomic data elsewhere around the world also showed encouraging signs, further supporting the prospect of a soft landing. Against this backdrop, global equities posted strong returns, with the MSCI ACWI up +9.6% (GBP terms) during the first quarter. Q1 2024 was a more challenging period for fixed income. A combination of stickier inflation prints, resilient economic activity, and the Fed backpedalling somewhat on its dovish December tone, drove negative returns for sovereign bonds. As prospects of aggressive rate cuts faded, the yield of the Bloomberg Global Aggregate increased to 3.7%, which led to negative returns of –2.1%. Other interest rate sensitive asset classes, such as real estate, also suffered on the back of higher interest rates. The Global REITs Index ended the quarter down –1.1% (GBP terms). In commodity markets the fall in gas prices was more than offset by a rise in oil prices on the back of ongoing supply cuts and geopolitical tensions.

3.2 Developed market equities had a strong first quarter thanks in large part to the performance of growth stocks, which returned +10.7% (GBP terms). This was especially true in the US, where the S&P 500 rose +11.8% (GBP terms), outperforming most of its peers, driven once again by the stellar performance of the 'magnificent seven' stocks. The Japanese TOPIX index ended up +10.5% (GBP terms) in the first three months of the year, despite the Bank of Japan beginning the normalization of its monetary policy in March. The central bank announced an end to its negative interest rate policy, yield curve control, and its purchases of equity exchange traded funds and real estate investment trusts. European stocks did lag the US and Japan but cheaper valuations and a potential shrinking of the economic growth gap relative the US are making the regional market look more attractive.



Source: MSCI, Bloomberg, Border to Coast.

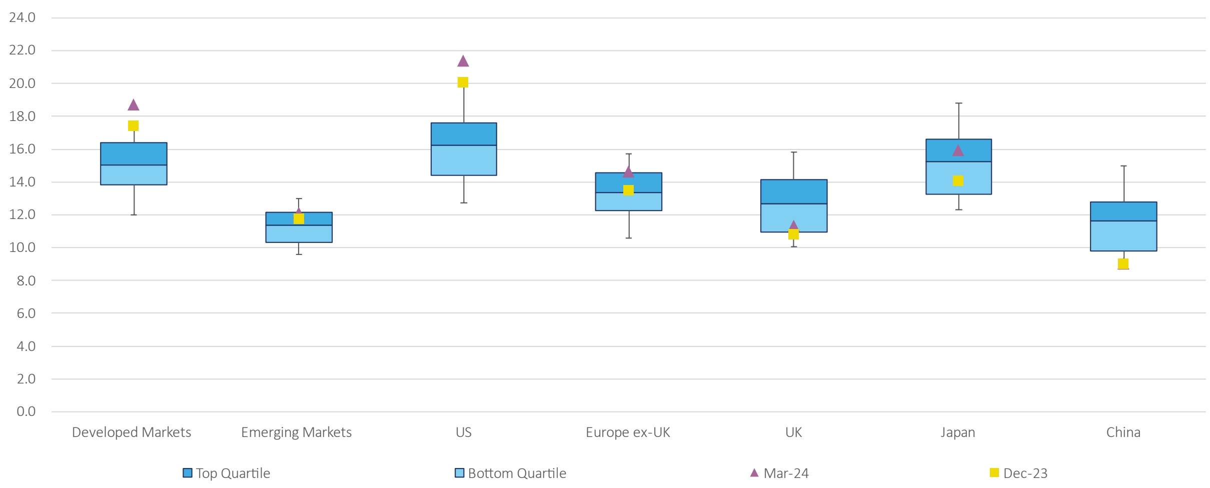
3.3 The broadly healthy global nominal GDP environment is a tailwind for earnings. The typical pattern is for current year earnings estimates to be revised lower as time goes on with over-optimistic expectations being marked to market. As earnings have been relatively robust, equity markets have powered ahead. Nevertheless, there is now a growing differential between the performance of equity markets and earnings growth – with the former pushing ahead. This does leave the market vulnerable in the second half of 2024.



Source: MSCI, Bloomberg, Border to Coast.

3.4 Equity market valuations are now high but there are notable differences in regional blocks. The hunt for positive growth momentum and attractive valuation is starting to shift investors' focus away from US and towards more regionally diversified exposure, where the scope for catch up appears greater. UK and China are decidedly cheaper than the US Market.

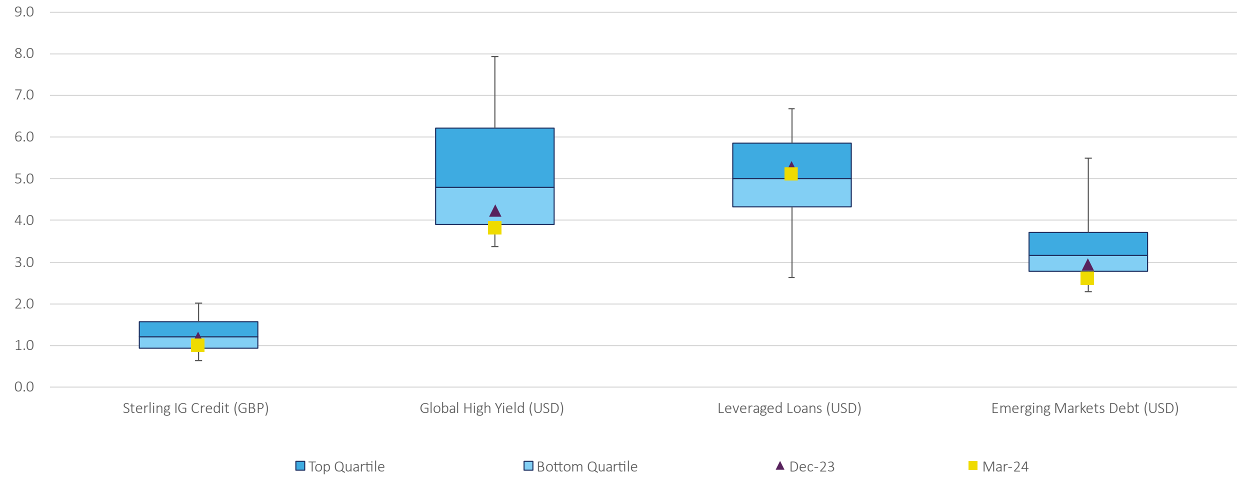
Equity Market Valuations (P/E)



Source: MSCI, Bloomberg, Border to Coast. Data shown from June 2003 to December 2023. . Whiskers show the top and bottom deci le of historical spreads.

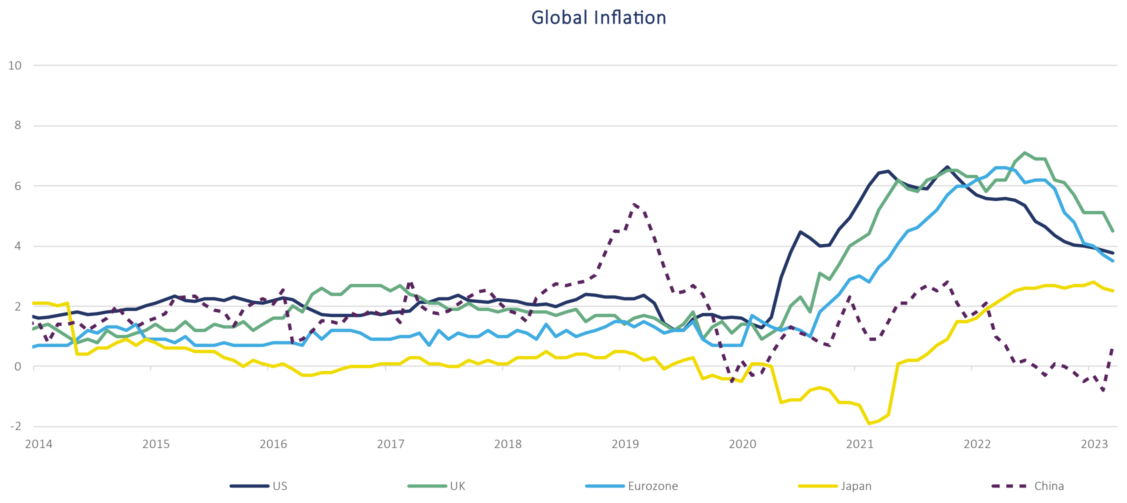
3.5 Fixed Income Markets continue to offer very good yields, however credit spreads tighten further over the quarter. This tightening helped to offset the sell-off we saw in developed-market sovereign rates as higher yielding credit markets delivered positive returns over the quarter. In an environment where interest rates are likely to stay higher for longer, we continue to see support for these asset classes as investors continue to diversify their equity exposure.

Credit Spreads



Source: Bloomberg, Border to Coast. Note: Data shown since 31 August 2001 to 31 December 2023. Whiskers show the top and bottom decile of historical spreads.

3.6 Improving manufacturing data and intensified geopolitical tensions in the Middle East resulted in higher oil prices providing a cyclical uplift to headline inflation. Taking these two factors into account the pace of disinflation has halted forcing developed central banks to push rate cuts further into the future.



Source: Bloomberg, Border to Coast.

4 Looking Forward

4.1 Economic conditions are solid and yet global central banks are still embarking on a modest synchronised easing cycle. Global growth is broadening out across regions and profits are holding up much better than expected. This remains a uniquely positive backdrop for risk assets.

4.2 This environment is not without its risks as equity valuations and credit spreads are quite elevated relative to their own history. However, the new interest rate regime is offering investors the ability to diversify to a broader set of asset classes.

4.3 The high level of capital market commitments from Partner funds to Alternatives 2c and Climate Opportunities 2 & UK Opportunities 1 confirms the very strong desire to continue to diversify into private markets.

5 Author

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7 June 2024

Important Information