AGENDA ITEM 10

Border to Coast Pensions Partnership Limited

Joint Committee

Date of Meeting: **26 September 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.

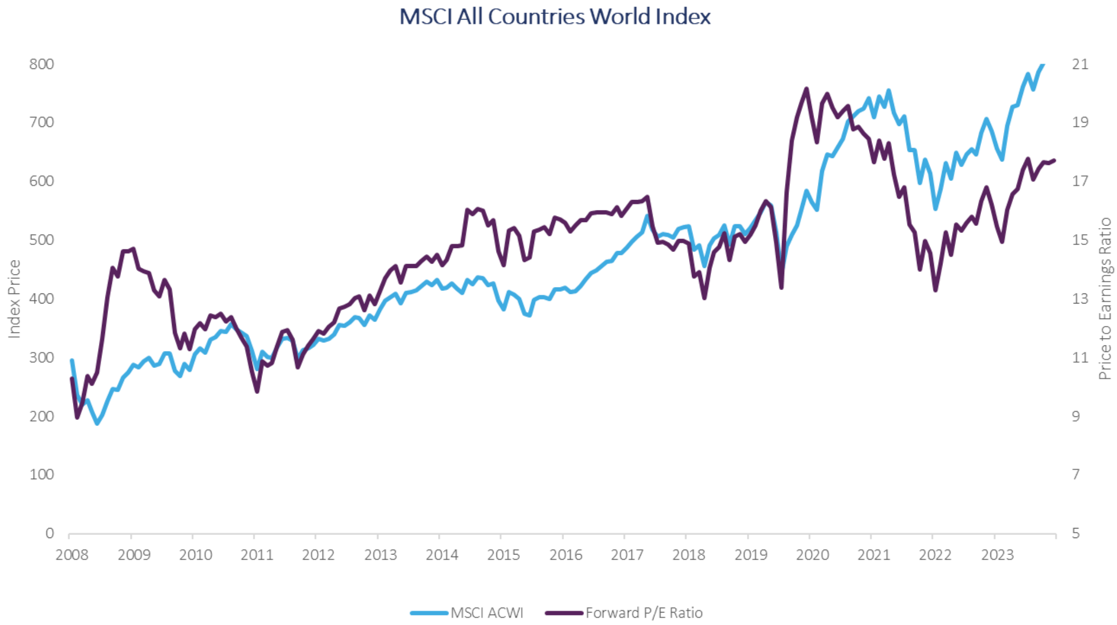
3 Markets & Macroeconomic environment

3.1 Macroeconomic data releases during Q2 continued to show a steady performance by developed market economies. While the pace of expansion has slowed and some measures missed expectations, growth remained firmly in positive territory. Meanwhile inflation data gave central banks more confidence that they are winning the battle. The European Central Bank began easing rates at its June meeting and the Bank of England followed suit in early August.

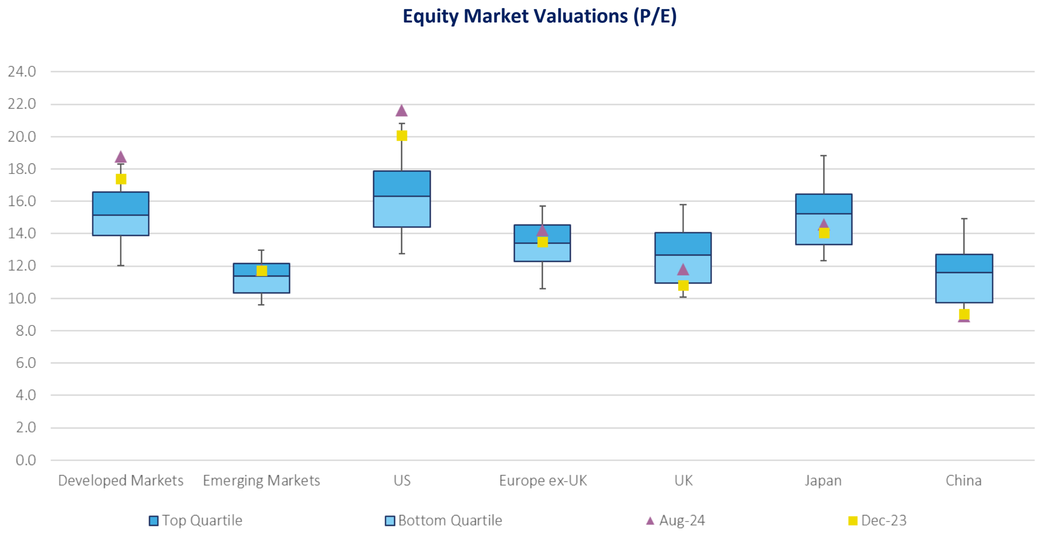
3.2 Against this backdrop equity markets made further gains with the MSCI ACWI up +2.17% (GBP terms) during the second quarter. French elections caused a brief patch of turmoil in European markets, but this was quickly reversed as a possible victory by Marine Le Pen's populist party was averted.

3.3 Fixed Income markets traded in a narrow range as investors awaited further data to determine the timing and pace of US rate cuts. The yield of the Bloomberg Global Aggregate closed the quarter just 0.16% higher at 3.90%, 0.15% below its April peak. The index returned -1.10% (GBP terms) over the quarter as yields closed slightly higher and credit spreads slightly wider. Other interest rate sensitive assets classes, such as real estate, also drifted modestly lower as the Global REITs Index fell -1.70%. (GBP terms). Commodity markets also traded in a narrow range during the quarter with the oil price closing down just 2.0%

3.4 The Japanese TOPIX index was more volatile than other developed economies as it ended down -4.7% (GBP terms) in the quarter as a modest 1.7% gain in local currency terms was offset by a fall in the Yen as FX markets grappled with the fact that Japan is raising rates while most other developed economies are looking to cut.

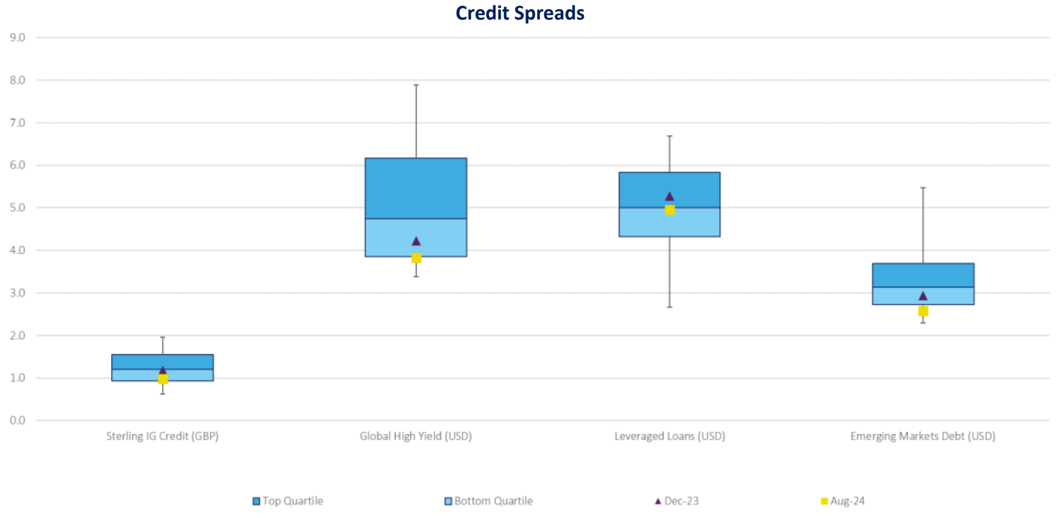


3.5 Global Equity valuations continued to expand driving most of the market performance in Q2. These strong returns have been delivered by a small group of dominant technology companies with the ability to leverage the hopes and aspirations around Artificial Intelligence. Narratives have the power to attract and direct capital, however, sentiment can also play a role in speculation that can monopolise investors' imagination at the expense of other opportunities and investors tend to underestimate the scale of new competition and the impact on future returns. The high level of concentration risk in the US market is of concern. Diversification is key in navigating this kind of environment, and we believe that equity markets outside the US offer some compelling opportunities from a valuation perspective.



3.6 Fixed Income yields peaked late-April as markets began to believe that the US Federal Reserve could soon begin cutting rates. Key benchmark yields finished the June quarter close to where they started. The Fixed Income asset classes continued to see support as they demonstrated their traditional diversification qualities with the yield buffer providing income while a flight to quality boosted prices as equity markets became more volatile.

3.7 Global credit markets performed well during the recent equity volatility, with a stable corporate earnings outlook continuing to support the asset class. Credit spreads are a few basis points higher than their post-GFC lows and they remain tight relative to historical averages however continue to offer good income and the capacity for further gains as rate cuts are delivered. Higher yielding credit markets should continue to deliver positive returns primarily due to the income they generate.



3.8 Over the quarter the inflation picture moderated with both CPI and PPI prints confirming a disinflation trend has been established which gave US Fed speakers scope to deliver several unequivocally dovish speeches in more recent weeks.

4 Looking Forward

4.1 Markets are at an important juncture - as growth has slowed and easing cycles begin conversations naturally turn to the risk of recession. While economic growth has moderated, it remains firmly in positive territory. Corporate earnings remain strong, and that strength is broadening outside the technology sector, there is also a lack of obvious structural imbalances in the economy. Current conditions reflect an economic backdrop that is much healthier than before previous examples of easing cycles which led to recessions.

4.2 Volatility has increased as markets debate the timing and extent of rate-cuts, however recession fears seem premature. In terms of monetary policy many central banks have begun to ease so the market debate has shifted from the timing of the first cut to what will be the pace and extent of further cuts. Markets have become more sensitive to data as each time expectations are exceeded or disappointed drives further volatility.

4.3 The interest rate environment continues to offer investors the ability to diversify. As the market's rate-cut conviction has grown many investors have increased fixed income allocations to lock-in yields. As a result, the market level of yields has steadily fallen (e.g. by early September the benchmark US 10-year Treasury yield was about 1% lower than its late-April peak). However, we still see value in fixed income markets for the diversification potential offered by duration as well as the income generated from yields and credit spreads.

4.4 This environment is not without its risks as equity valuations and credit spreads remain quite elevated. The US election is a significant source of near-term uncertainty, and it is reasonable to expect further periods of volatility in the lead-up.

5 Author

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10 September 2024

Important Information