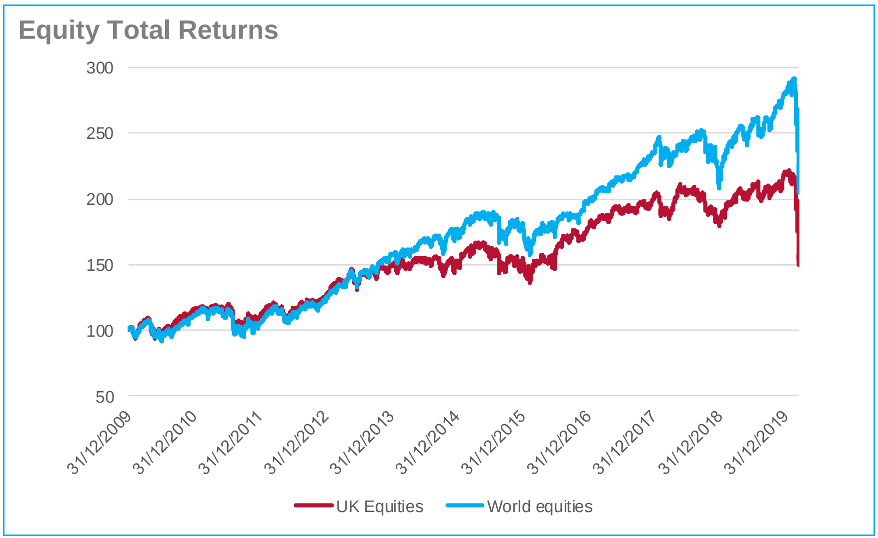
Market Update – 17 March 2020

As you will be aware, volatility has spread across financial markets as Coronavirus has spread across the globe. In this update, we present some statistics to help you put recent financial developments into context.

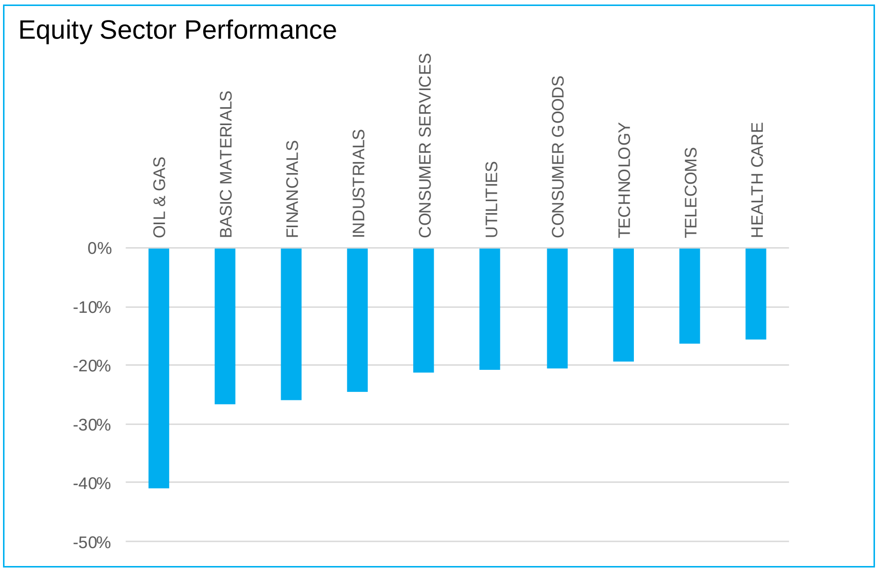
Global equity markets have crashed



The fall in global equity markets has been dramatic with around 30% of value being lost between 19 February and 16 March.

The chart alongside shows the 10-year history of UK and World equities and is based on data to the close of markets on Monday 16 March.

The recent equity market falls have taken equity markets back to levels last seen in 2016.



All industries have been adversely affected by recent events but, perhaps unsurprisingly, more defensive sectors such as healthcare and telecoms have held up best.

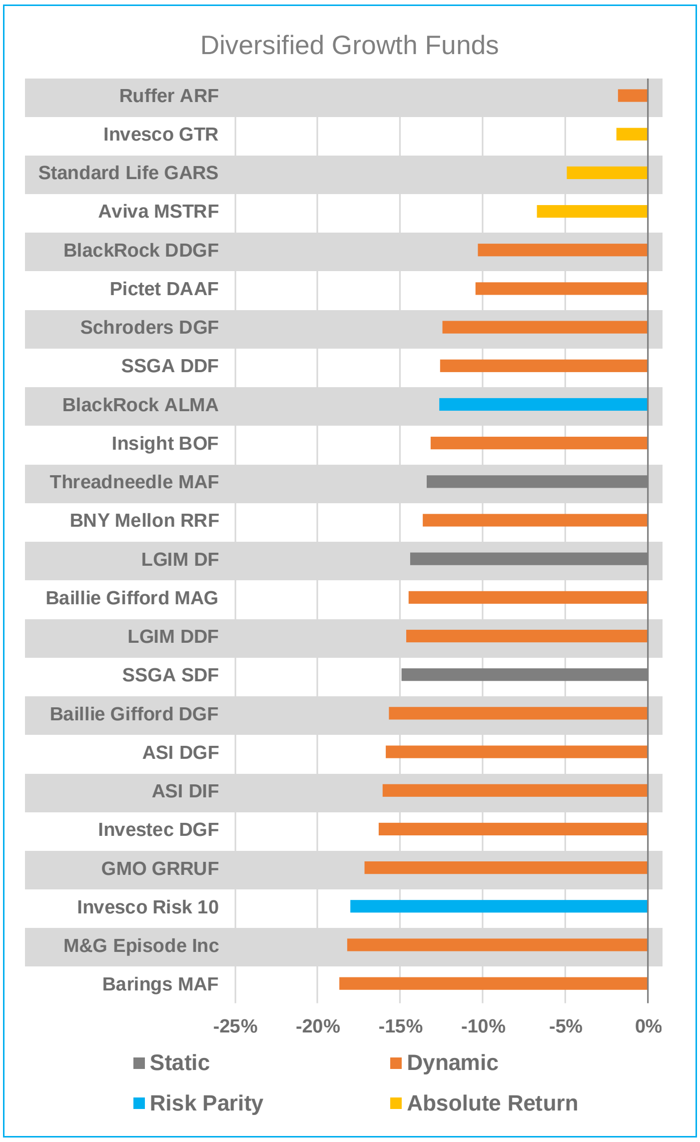
Oil & gas companies have been particularly badly hit, with disagreements between OPEC and Russia affecting sentiment towards the sector.

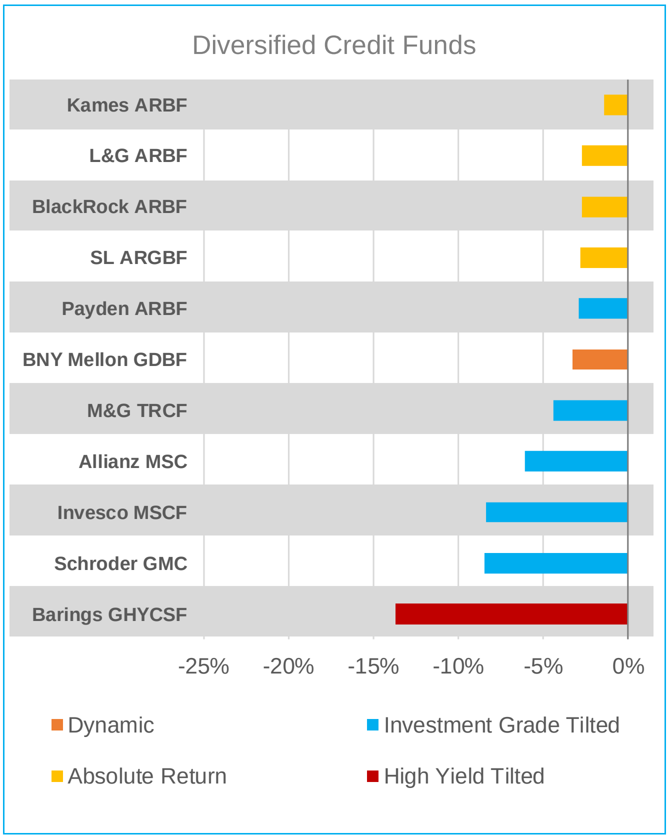
(Data is to 13 March)

Diversification has worked

Many pension schemes include an allocation to Diversified Growth Funds (DGFs) or Diversified Credit Funds (DCFs) in the expectation that these will offer long-term growth with lower volatility than equities. We would therefore expect these funds to have fallen by less than equity markets over recent weeks and this has proved to be the case.

The recent performance of DGFs and DCFs which we routinely monitor is shown below. Performance stated is from 19 February to 16 March 2020*. For comparison purposes, equities markets fell by about 30% over this period.





**With the exception of the following funds, which are up to 13 March 2020: Aviva MSTRF, Pictet DAAF, M&G TRCF and Payden ABRF.*

Fund performance has been calculated from a price feed published by Thomson Reuters Datastream (the only exception being the SSGA funds where data has been sourced from SSGA's website). The performance of a scheme's actual DGF investments may differ slightly from the numbers presented in this update depending on the share class held.

The colours of the bars reflect our assessment of the styles of different funds. Absolute Return Style funds (yellow bars) are expected to be less sensitive to general market trends and these funds have been amongst the strongest performing funds in both peer groups.

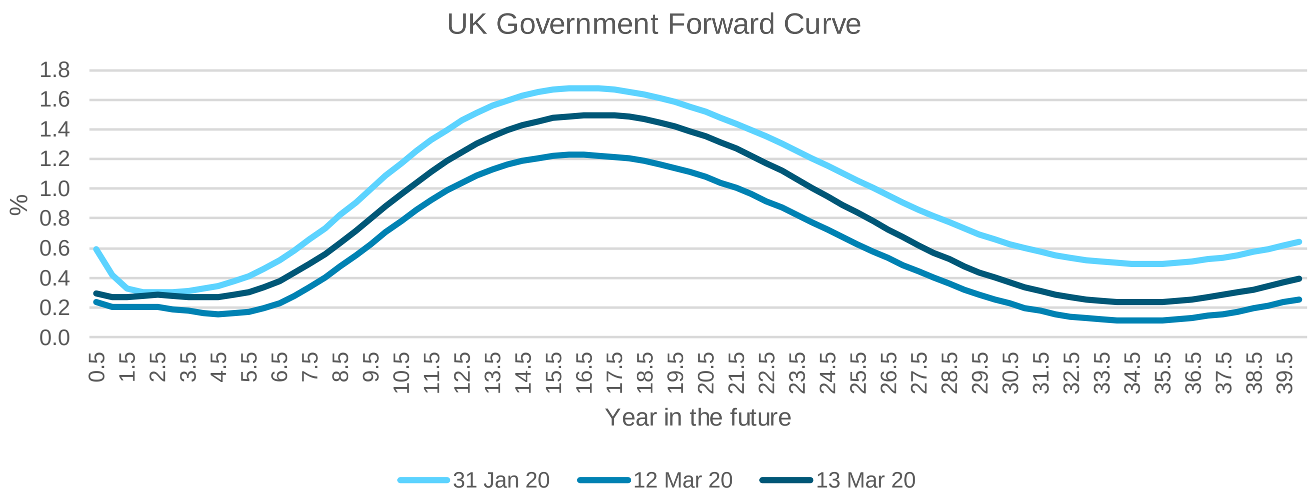
These charts have been uploaded to our online Hub and are available to any clients where we provide a regular performance monitoring service. We will continue to upload regular updates to the Hub as market conditions evolve over the coming weeks.

Gilt yields & inflation

In gilt markets, yields fell steadily over the period from 31 January until 12 March but then increased sharply on 13 March (the latest available date).

The forward gilt curve provides an indication of how UK base rates are expected to evolve. At the short end, the curve has dropped to reflect the Bank of England's rate cut last Wednesday and the expectation now appears to be that rates will be held low for several years to come.

Since 31 January, the market's expectation is that future inflation will be lower. Probably in anticipation of a global economic slowdown.



What do these yield curve movements mean for pension scheme liabilities?

The actual impact for a particular scheme will depend on the maturity of the liabilities and the split between inflation and fixed increases.

For a typical scheme (looking at the movement of representative gilt indices):

- fixed liabilities increased by nearly 2% over the period from 31 January to 13 March; whereas
- inflation-linked liabilities decreased by nearly 4% over the same period.

LDI funds are performing as expected

The values of LDI funds have responded as we would have expected and will have offset the impact of the liability movement for those schemes holding LDI. The increase in value of several LDI funds over the period to 12 March was sufficiently large that cash pay-outs will be paid over the coming weeks to increase leverage back to target levels. This is in line with the normal operation of such funds.

The transaction costs associated with buying or selling LDI funds have increased over recent days.

Impact on scheme funding positions

The actual movement in a scheme's funding position over recent weeks will depend on the investment strategy adopted. Schemes with a diverse portfolio of Growth Assets and a high level of liability matching will have fared better than those with low matching and high equity exposure.

For trustees who subscribe to our daily funding monitoring service, the impact of recent market changes on the scheme's funding position is shown on our online Hub.

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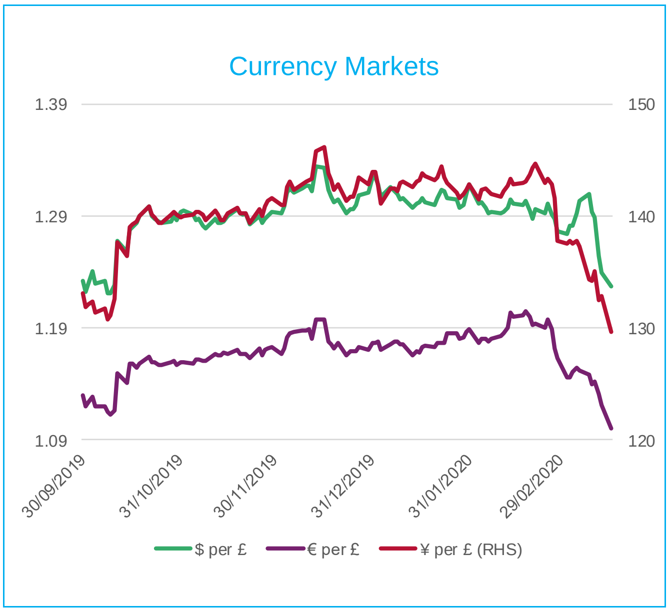
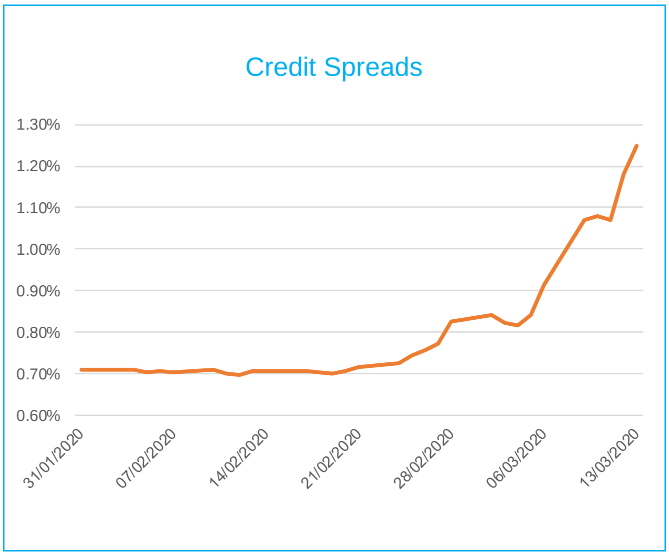


Sterling has depreciated against the dollar, the Euro and the Yen over recent days. This means that it would have been favourable to have left overseas currency exposure unhedged over this period.

(Data is to 16 March)

There has been a material widening in the credit spread meaning gilts have increased in value more than corporate bonds of a similar duration (the chart is to 13 March – reflecting the most recent data available to us).



"The credit spread increasing suggests investors are nervous about the default risk and/or the liquidity of corporate bonds"

Further information

For further information, please contact your usual First Actuarial investment consultant

Important Notes

First Actuarial works entirely on a fee basis when providing investment advice. This means no commission or other payment is made to First Actuarial by fund managers in respect of any monies invested with them.

Past performance is not a guide to future returns. The value of assets referred to in this report can fall as well as rise.

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