Appendix A

Q3 2023
Capital Markets Outlook

Essex Pension Fund

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Private equity investments, whether held directly or in pooled fund arrangements carry a higher risk than publicly quoted securities. The nature of private equity pooling vehicles makes them particularly illiquid and investment in private equity should be considered to have a long time horizon.

Disclaimer

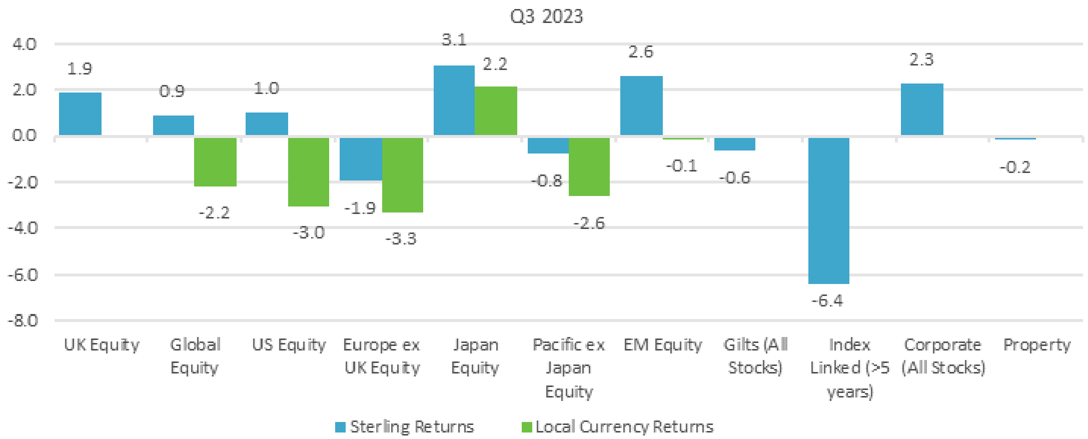
Market background

Market Returns

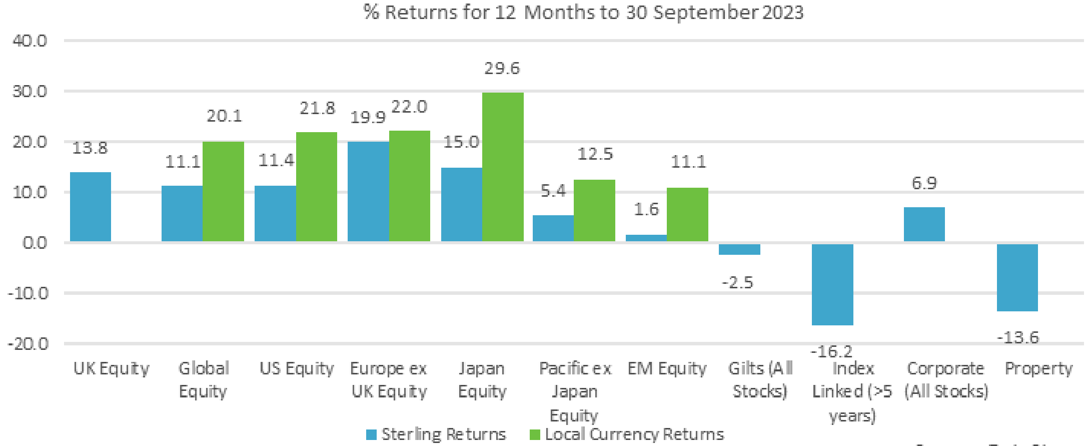
Better-than-expected Q2 data, released in Q3, led to further upwards revisions to 2023 global growth forecasts for Q3. Survey indicators suggested that economic activity weakened in Q3, particularly in Europe, but growth is expected to slow, rather than collapse.

While inflation generally declined, it remained above target, and markets are coming to expect that central banks will have to keep interest rates higher for longer to return inflation to target.

Against this backdrop, sovereign bond yields rose, and global equity markets weakened. Perhaps owing to reduced expectations of outright recessions, credit spreads marginally tightened.



Source: DataStream



Source: DataStream

Asset class views

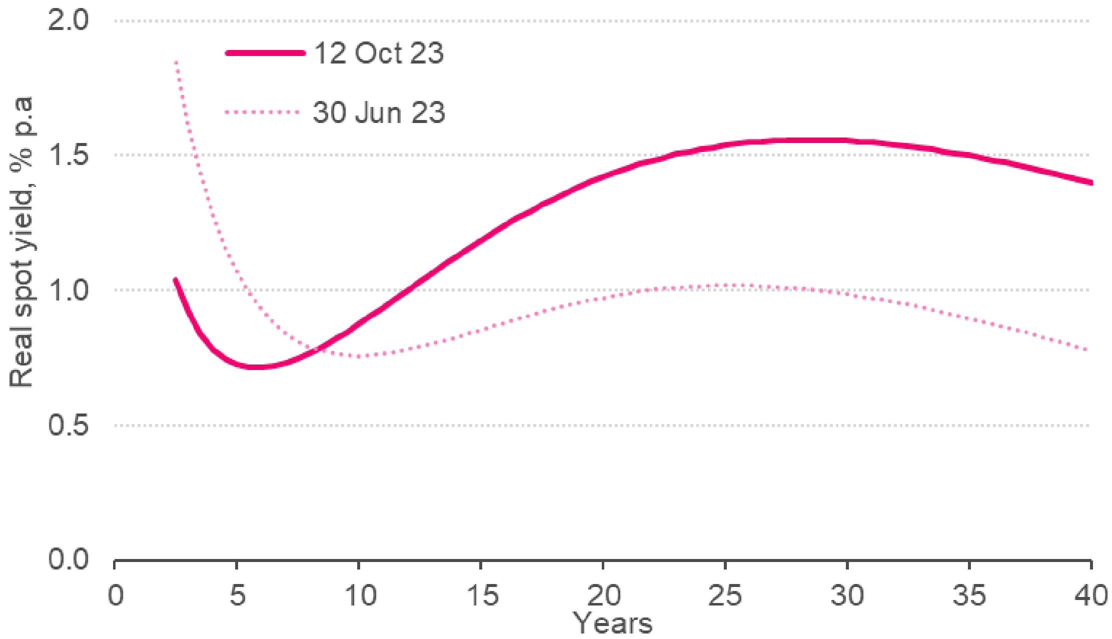
HYMANS ROBERTSON

Index-linked government bonds

Real yields also look reasonably attractive versus our assessment of fair value

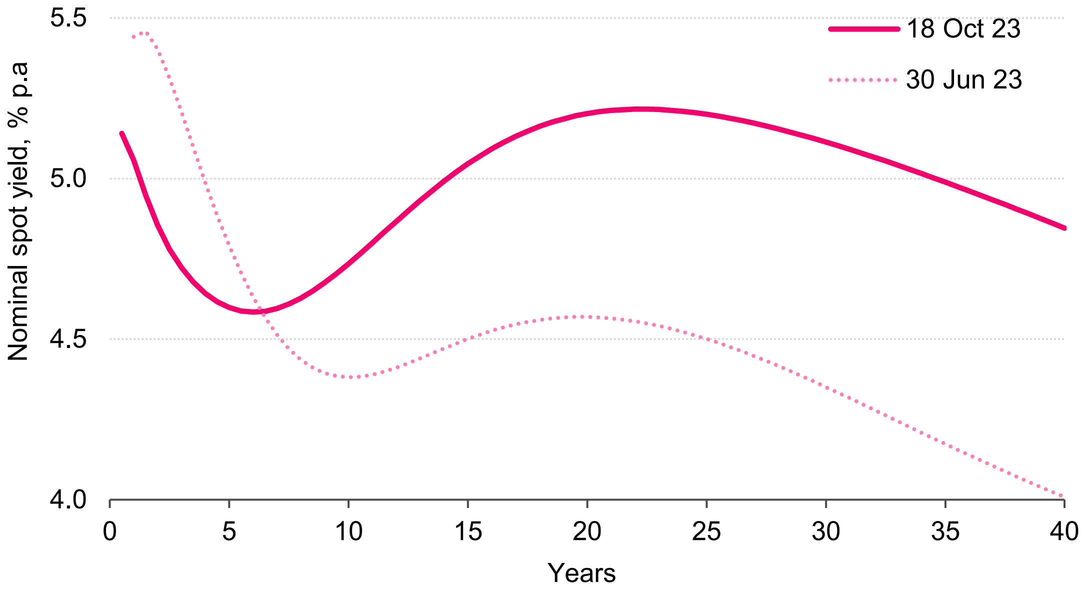
The technical backdrop is slightly less challenging for index-linked gilts: index-linked gilts are not being sold as part of quantitative tightening; the DMO may be likely to reduce linker issuance if demand dries up; and, even if DB buy-outs and deleveraging reduced demand, insurers still ultimately hedge inflation risk.

Given our belief that central banks will ultimately use the tools at their disposal to return inflation towards target, we also expect long-term implied inflation to fall. We think a decline in longer-term implied inflation is more likely to be driven by a fall in nominal yields than a rise in real yields.



	Fundamentals	Valuations	Technicals	Overall
Index-linked	Attractive	Neutral-Attractive	Neutral	**Attractive**

Government bonds



	Fundamentals	Valuations	Technicals	Overall
Gilts	Neutral	Very Attractive	Unattractive	**Attractive**

We have little issue with the near-term path of interest rates implied by the market, but we do not think interest rates will remain as high for as long as suggested by forward nominal yields.

Forward yields remain above our assessment of fair value at all but the very longest terms, but sharp falls at longer terms suggest the best value is on offer between 10 and 20 years.

Government financing requirements and redemptions means gilt issuance is increasing at a time when the Bank of England, who has recently been a key buyer in recent years, is selling nominal gilts. This, alongside the trend of corporate DB schemes moving to buyout, poses a challenging technical backdrop.

Investment-grade corporate credit

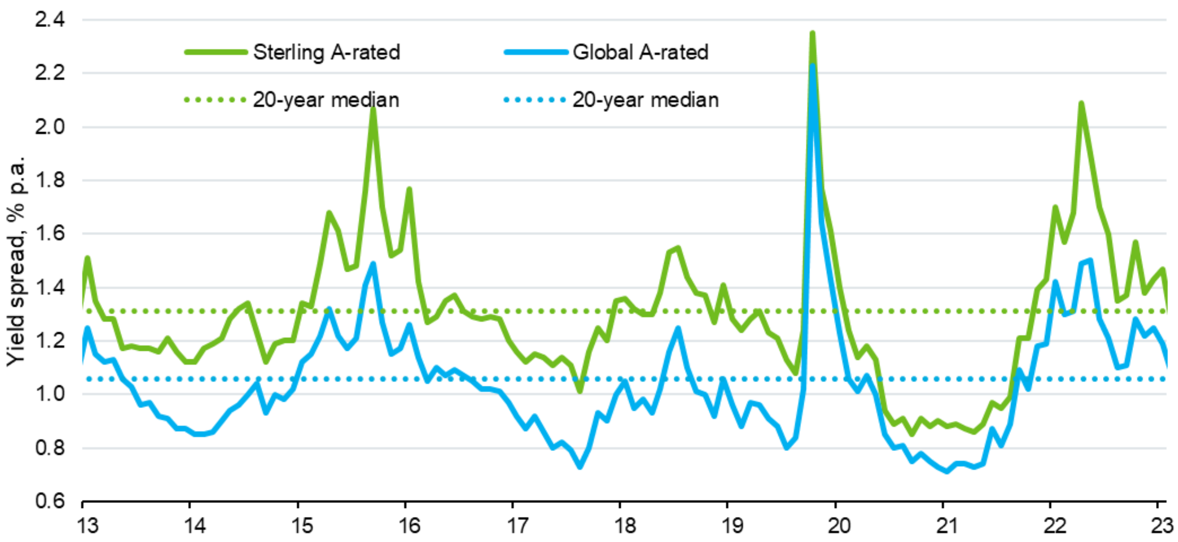
The fundamental outlook for credit is challenging.

Our assessment of valuation has been shaded down by recent spread tightening with global A-rated spreads more or less in-line with long-term median levels, at 1.1% p.a.

Given more attractive all-in yields and de-risking activity, institutional demand lends a degree of technical support to global investment-grade credit markets.

However, sterling credit markets face further technical headwinds with the BoE aiming to increase gilt sales from £80bn to £100bn over the next 12 months.

Spreads (bps)	30-Sep	-3 Mth	-12 Mth	10-yr Median
US A IG	**125**	130	167	**128**
Sterling A IG	**131**	147	209	**128**
Euro A IG	**151**	161	221	**115**



	Fundamentals	Valuations	Technicals	Overall
Global IG credit	Unattractive	Neutral	Neutral	**Neutral**
Sterling IG credit	Unattractive	Neutral	Neutral	**Neutral**

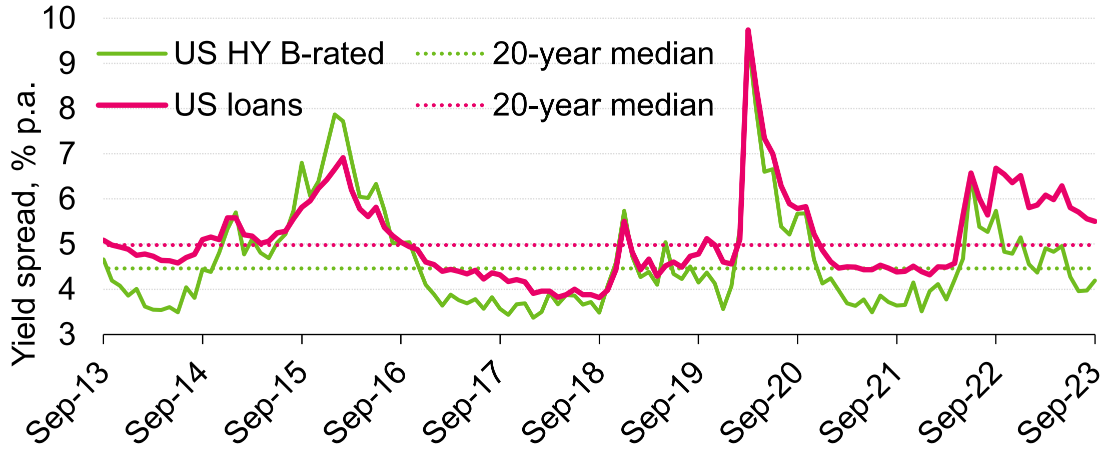
Speculative-grade credit

Speculative-grade default rates have risen above long-term average levels, but given strong corporate balance sheets and unexpected economic resilience in the US, defaults are only expected to rise a little further – a fairly benign outcome relative to past slowdowns.

However, high yield bond spreads at long-term median levels provide little additional compensation against a greater-than-expected rise in defaults as higher borrowing costs and slowing growth impact debt affordability.

Valuations, relative to the traded loan markets, are attractive when compared to new issuance in the market (which is now functioning again).

Spreads (bps)	30 Sept	-3 Mth	-12 Mth	10-yr Median
US HY	**403**	405	543	**410**
Euro Currency HY	**459**	458	632	**396**
US Loans 3-yr DM	**551**	581	668	**487**
Euro Loans 3-yr DM	**521**	595	769	**483**



	Fundamentals	Valuations	Technicals	Overall
High yield	Unattractive	Neutral	Neutral	**Neutral to Cautious**
Loans	Unattractive	Neutral to Attractive	Neutral	**Neutral to Cautious**
Private debt	Unattractive	Attractive *(relative to US loans)*	Neutral	**Neutral**

Global equities (returns)

The overall equity market environment was influenced by a combination of factors, including weaker forward-looking data, rising yields and renewed concerns around Chinese growth. These challenges look to persist and are likely to contribute to a broader dampening effect on global markets.

Energy emerged as the strongest performing sector in the quarter driven by an increase in oil prices due to expectations of reduced global supply.

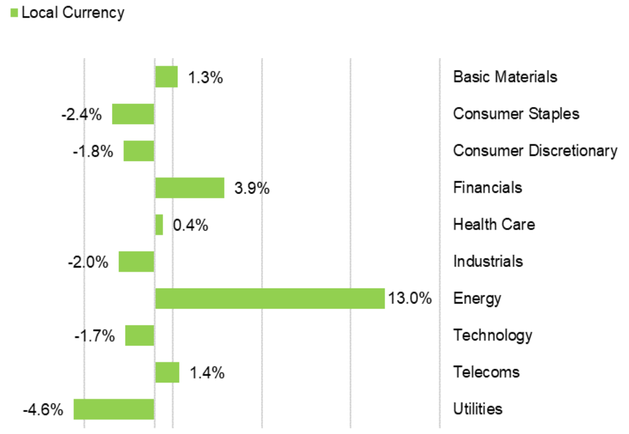
Utilities were a noticeable underperformer due to a rise in long-term sovereign bond yields, impacting its bond-like characteristics.

Japan stood out as the best performing region, benefitting from robust economic data and a weakening yen that boosted net export growth.

Europe underperformed given particularly weak forward-looking economic data and its large exposure to the struggling manufacturing sector.

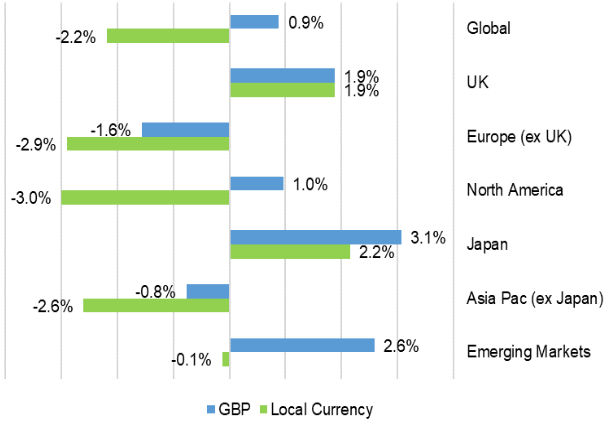
The UK’s above-average exposure to energy and financial sectors stood it in good stead for good performance over the quarter.

Relative Q3 equity sector performance



Global Sector returns relative to FTSE All World Index 30 Jun 2023 to 30 Sep 2023. Source: Datastream

Q3 Regional Equity performance



Total returns 30 Jun 23 to 30 Sep 23. Source: DataStream

Global equities

MSCI World cyclically adjusted earnings yield

	Fundamentals	Valuations	Technicals	Overall
Global equity	Unattractive	Neutral	Neutral	**Neutral to Cautious**

Consensus global corporate earnings growth expectations for the 2023 have settled at 0.7%, although equivalent estimates for 2024 and 2025 are healthier at 10% and 11% respectively. However, we continue to view risks from here as skewed to the downside with further scope for disappointment as policy remains tight and the impact on consumer activity from inflated interest and inflation rates.

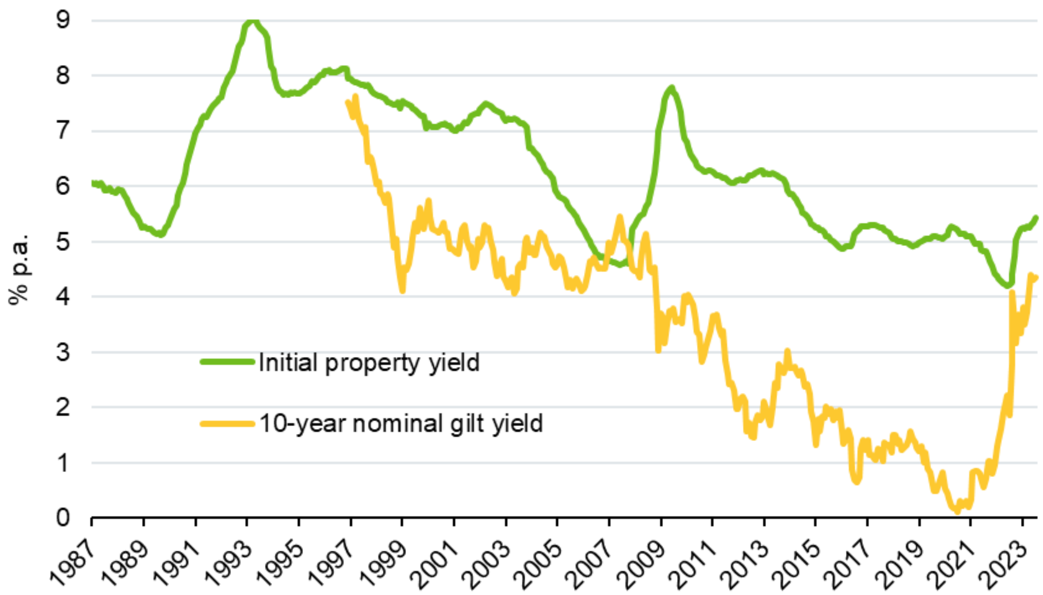
Global developed equity valuations are now in line with long-term medians, although far below their peak from the beginning of 2022.

Spread between the MSCI World's cyclically adjusted earnings yield and US 10-year real yield has been below both its post-crisis median as the rise in real yields has outpaced the rise in earnings yield. This suggests equities are looking more expensive relative to bonds versus history.

Our view on global equities remains neutral to cautious.

UK Property

Yields continue to rise – however, relative to gilts and other assets the yield premium on property looks very low versus longer-term history



	Fundamentals	Valuations	Technicals	Overall
UK Direct	Unattractive	Neutral to Unattractive	Unattractive	**Cautious**

The UK property market remains challenging with thin depth as some transactions continue to take place.

Real rental growth has been suppressed due to the current high inflation environment. As this is our primary fundamental indicator it has largely contributed to our view that UK property is fundamentally unattractive.

We believe capital values may come under pressure as the market continues to absorb the ongoing redemption pressure while the effects of rising interest rates impact the availability and cost of debt.

Property yields have risen significantly from a very low base at the market peak in the summer of 2022, pushing yields close to our neutral band.

There will be opportunities for long-term investors to enter the market at more attractive yields by buying at a discount to existing market values.