Investment Update

The LCP Monthly Brief – December 2022

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Equities

A dim outlook for 2023 resulted in equity markets falling sharply by 7.4% (in € terms) in December as the traditional end of year 'Santa Claus rally' failed to materialise. The Euro witnessed a resurgence against the US dollar in December following a challenging year. This provided some protection for those investors who took a hedged position.

2022 was ended with a warning from the head of the International Monetary Fund (IMF), Kristalina Georgieva, that a third of the world's economies will experience a recession in 2023. Georgieva noted a continuation of factors that have plagued 2022, including the Russo-Ukrainian War, rising prices, higher interest rates, and the rapid spread of Covid in China.

US tech stocks – heavily tied to the Federal Reserve's macroeconomic policy – experienced a testing December as Chairman Jerome Powell remained committed to combating inflation, proclaiming "We will stay the course until the job is done".

Bonds

Long-dated core Eurozone bond prices fell 11.4% over the month, with the yield on the AAA Eurozone 15+ Year Index rising 0.7% to 2.6% by month-end. Prices fell by 9.7% on the Euro Broad Sovereign 10+ Year Index, with its yield rising by around 0.7% to just under 3.5% by the end of December.

In Europe, interest rates hikes continued, as the European Central Bank (ECB) warned "interest rates will still have to rise significantly at a steady pace". However, promising news emerged from Germany, as the country's federal statistics agency reported inflation slowed quicker than expected, falling below 10%.

Sample DB Scheme

The funding level of our sample DB scheme decreased to 96.8% as its assets fell by more than its liabilities (calculated using an MFS proxy) over December.

Sample DC Schemes

Our three sample DC Strategies all fell as most asset classes were negative for the month.

All returns are in € terms	Dec '22 %	3 Months %	Year to Date %	1 Year %	3 Years % pa	5 Years % pa	10 Years % pa
Equities							
FTSE World	-7.4	1.2	-12.1	-12.1	6.9	8.8	11.2
FTSE World (€ Hedged)	-4.6	7.5	-15.3	-15.3	5.6	6.7	10.0
FTSE Eurozone	-3.4	12.9	-12.1	-12.1	2.7	3.7	n/a
FTSE World ex Eurozone	-7.7	0.2	-12.1	-12.1	7.3	9.3	11.7
FTSE North America	-9.1	-1.6	-13.7	-13.7	9.1	11.7	14.4
FTSE Emerging Markets	-4.3	-0.3	-11.5	-11.5	0.3	2.5	4.5
Bonds							
Euro Sovereign AAA (15+ yr)	-11.4	-6.0	-36.1	-36.1	-12.9	-4.9	0.1
Euro Broad Sovereign (10+ yr)	-9.7	-3.9	-32.2	-32.2	-11.2	-3.7	1.6
Euro Inflation Linked	-6.5	-2.0	-18.8	-18.8	-4.8	-2.4	0.2
Euro Corporate (5+ yr)	-3.1	1.8	-20.6	-20.6	-6.7	-2.6	1.0
Other							
Commodities	-1.4	3.4	26.0	26.0	10.5	6.5	-3.3
Fund of Hedge Funds	0.0	0.8	1.0	1.0	5.1	4.2	4.2
€/$	3.8	9.2	-5.8	-5.8	-1.6	-2.3	-2.1
€/£	2.5	0.9	5.2	5.2	1.5	-0.1	0.9

Bond Index Yields	30 Nov '22 %	31 Dec '22 %	Change (b.p.) %
iBoxx Euro Sovereign AAA (15+ yr)	1.90	2.60	0.70
iBoxx Euro Broad Sovereign (10+ yr)	2.77	3.48	0.71
iBoxx Euro Corporates (5+ yr)	3.86	4.36	0.50

Sample Pension Schemes	Dec '22 %	3 Months %	Year to Date %	1 Year %	3 Years % pa	5 Years % pa
DB Schemes						
Assets	-8.0	-1.6	-21.5	-21.5	-2.0	2.4
Liabilities	-3.2	-0.6	-10.5	-10.5	-0.6	2.6
Change in Funding Level	-4.9	-0.9	-12.3	-12.3	-1.4	-0.2
DC Schemes						
High Risk Strategy	-4.0	1.7	-10.2	-10.2	3.6	5.1
Medium Risk Strategy	-6.5	-0.7	-18.4	-18.4	-1.0	2.6
Pension Purchase Strategy	-8.6	-4.3	-28.2	-28.2	-9.7	-3.6

Sources: LCP, Bloomberg, Reuters, MarketWatch, FT, Markit and iBoxx

Investment Update

Market Performance – Q4 2022

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Background

Global equity markets rose 1.2% (in € terms) in Q4 2022. However, market conditions remained highly volatile over the quarter as 2022 ended offering a dim outlook. Notably, growing recessionary concerns indicated a challenging environment for investors and policy makers alike in the new year.

Longer-dated Eurozone government AAA-rated bond prices fell by 6% (as yields rose) over the quarter. Central banks continued to implement interest rate rises to combat high levels of inflation, with the ECB raising rates to 2% p.a. (the highest level since the 2008 Financial Crisis).

Equity Performance

October: Following a fall of roughly 13% over August and September, global equity markets rebounded by 6% in October (in € terms). The unhedged euro investors experienced a similar return with a slight weakening of the US dollar. October saw the US dollar give up some of its recent gains following the publication of a weak economic outlook that affirmed rumours of a slowdown in the US Federal Reserve rate hike cycle. The news from across the Atlantic was welcomed as the Euro climbed 0.9% for the month but remains down 13% YTD.

A rebounding equity market performance throughout October was fuelled by large cap stocks. The energy sector reported record breaking Q3 profits on the back of soaring energy bills, with discussions of a windfall tax offering little to dent bullish investor sentiment.

November: Equities posted their second positive month in a row with a 3.1% rise in November (in € terms). The hedged euro investors experienced a higher return of 6.3% with a weakening in the value of the US dollar over the month. Investors reacted favourably to lower-than-expected inflation data in the US. Minutes from the Federal Reserve policy meeting suggested potential easing of interest rate hikes may be considered. Optimistic economic data from across the European Union further contributed to the positive performance over the month.

November saw the British Government launch a significant reset to their Fiscal policy. The UK's newly appointed Chancellor of the Exchequer, Jeremy Hunt, released the British Government's latest budget. The market reacted calmly to the announcement, as plans were drawn up for expenditure cuts, tax hikes and increases to both the state-pension and household benefits.

December: A dim outlook for 2023 resulted in equity markets falling sharply by 7.4% (in € terms) in December as the traditional end of year 'Santa Claus rally' failed to materialise. The Euro witnessed a resurgence against the US dollar in December following a challenging year. This provided some protection for those investors who took a hedged position.

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Bond Performance

Inflation continued to rise in **October** despite recent interest rate hikes by the European Central Bank (ECB) and is a primary concern for investors. Eurozone inflation hit a new record of 10.7% in October fuelled by high energy and food prices. The ECB made a further interest rate rise of 0.75% towards the end of the month to help combat the persistently high inflation figures. However, the impact rising interest rates will have on the economy is to be determined.

During **November**, several Central banks raised interest rates further with the ECB raising rates to 1.5%. Inflation was recorded at 10% for November which, although still at very high levels, was the first decline in seventeen months. Recessionary risk however remains a prominent concern within Europe.

In Europe, interest rates hikes continued throughout **December**, as the European Central Bank (ECB) warned "interest rates will still have to rise significantly at a steady pace". However, promising news emerged from Germany, as the country's federal statistics agency reported inflation slowed quicker than expected, falling below 10%.

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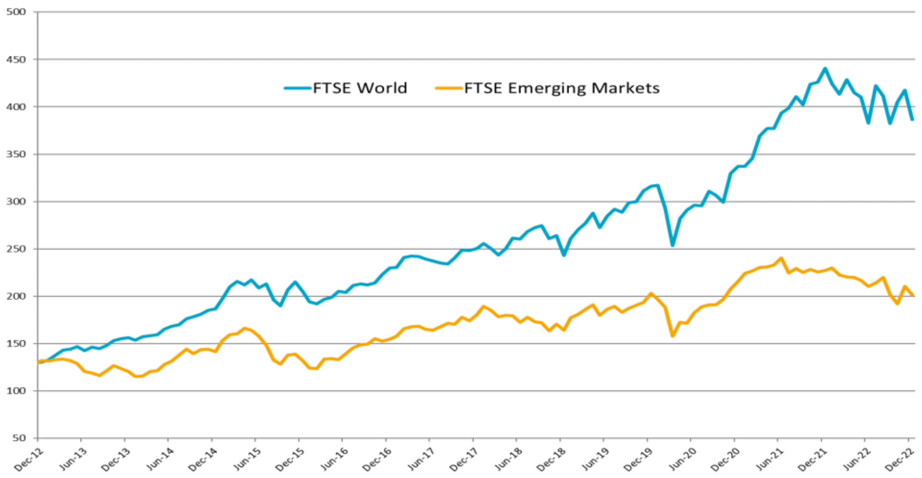
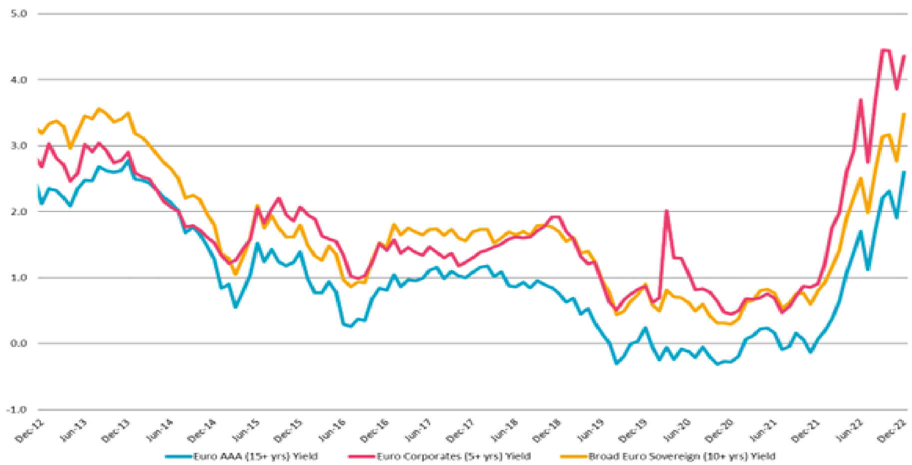
Equity Market Performance



Sample DB Funding Level Progression (MFS proxy basis)

Historical Bond Yields



Sample DC Scheme Performance