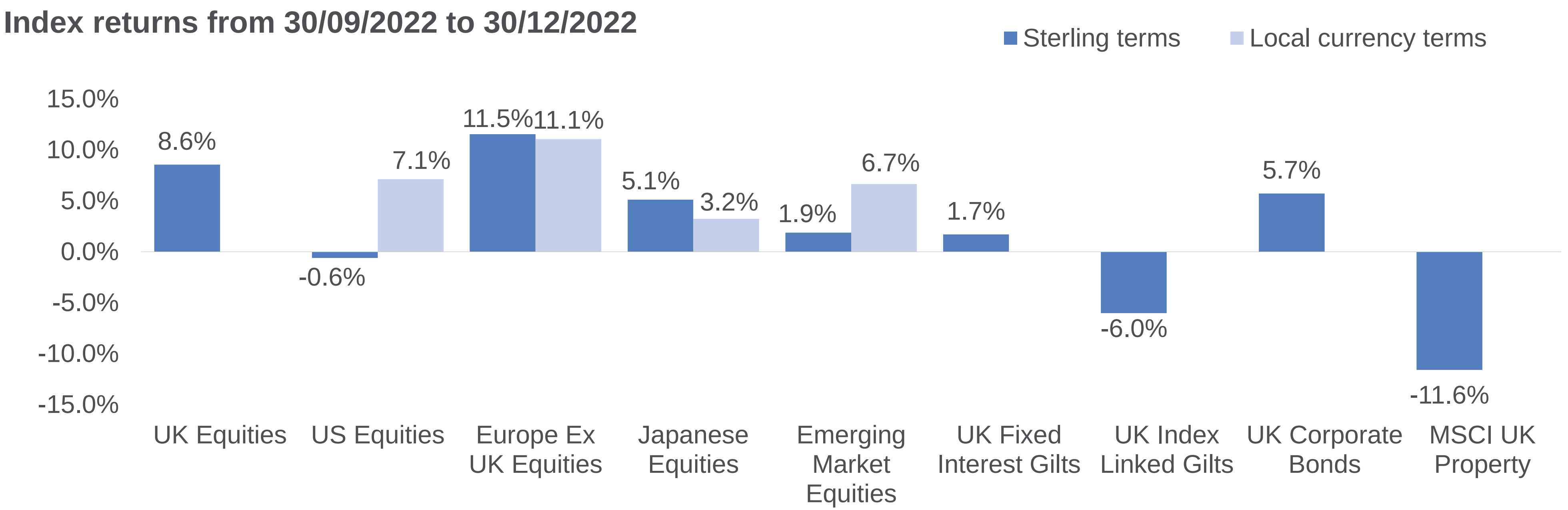
Market & Portfolio Update

January 2023

Prepared for: London Borough of Enfield Pension Fund
Prepared by: Aon
Date: 12 January 2023

Market update

Q4 2022 Index Returns



Source: FactSet, MSCI (Equities, Property), iBoxx (Corporate Bonds), FTSE (Gilts).

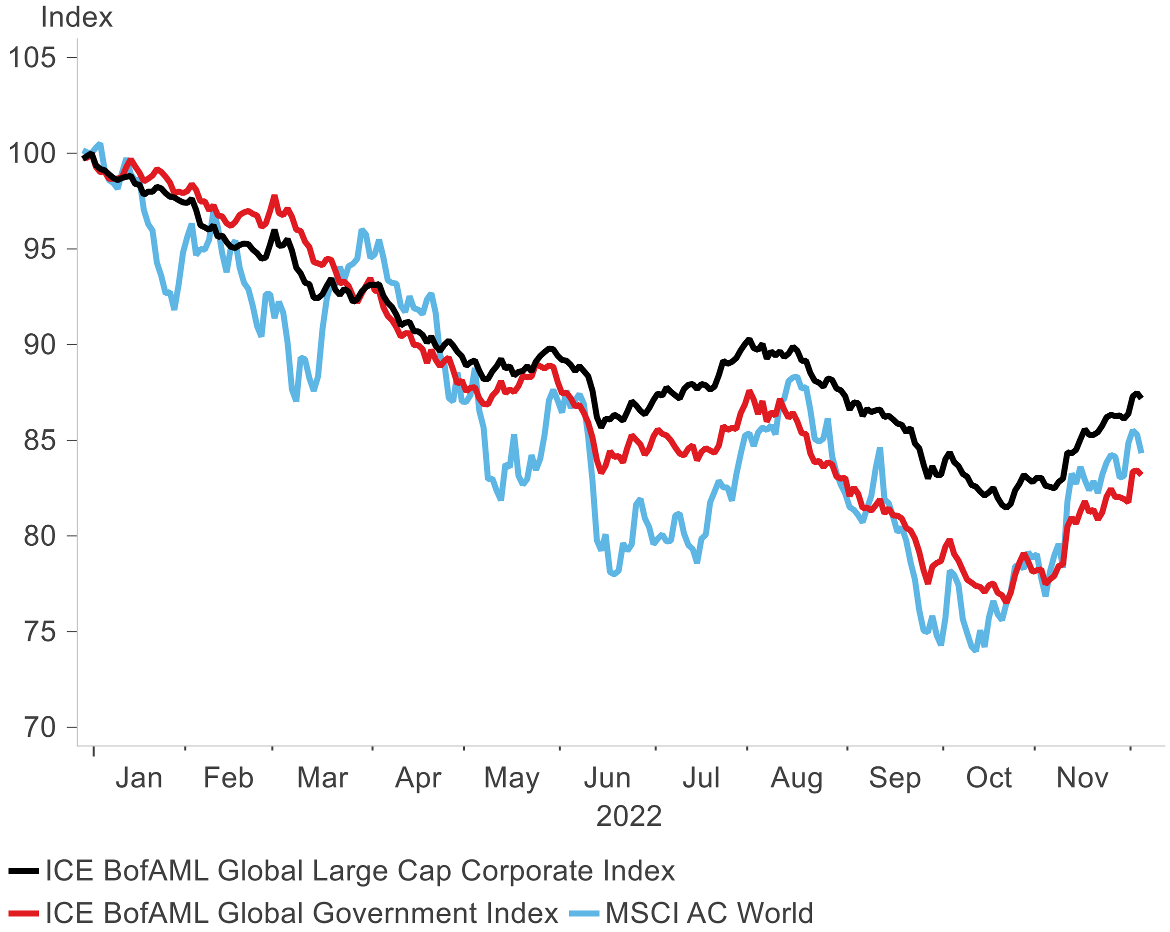
- Following widespread protests over China's so-called "zero covid" policy, Chinese authorities eased Covid-19 restrictions across major cities including Shenzhen and Beijing. It also announced plans to remove quarantine requirements for inbound travellers. Countries including the UK, the US, France, and India have imposed new Covid testing measures on visitors from China amidst reports of surging Covid cases in the country, although the EU resisted pressure for bloc-wide restrictions.

- The Bank of England raised interest rates by 50bps to reach 3.5%, the highest level since 2008. Six Monetary Policy Committee members voted for a 0.5% rate increase, whilst one member supported a larger 0.75% rise, and two members voted to keep rates unchanged.

- Both US and UK inflation eased in November, driven by a fall in energy prices. The US annual consumer price index (CPI) rose 7.1% year-on-year, down from the 7.7% recorded in October and less than economists' expectations of 7.3%. Meanwhile, UK CPI slowed to 10.7% year-on-year in November, down from the previous month's 11.1% and below economists' expectations of 10.9%.

A terrible year for the major asset classes – recent rally has been sharp but may not last

Equities and Bonds both perform very poorly



Source: Macrobond

- Both equities and bonds have suffered sharp falls in 2022.
- Resource-focused countries and sectors have outperformed – including energy, materials, UK, Canada.
- Weaker than expected US inflation has sparked a strong rally in the past 6 weeks, on expectations that central banks may stop raising rates.
- We do not believe that this is the end of the bear market yet, as inflation could persist for longer than currently expected.

Market Insights

Key questions for 2023

Interest rates

- **Consensus view:** Rates still have a bit more climbing to do but peak around mid 2023 and then start to come down
- **Risks to the consensus view:** Persistent inflation could keep rates high for much longer. But deep recession could force large cuts to rates

Bond Yields

- **Consensus view:** Will fall gently once rates peak and recession takes hold
- **Risks to the consensus view:** Similar to interest rates. All to play for here, and is key markets driver, as it was for 2022

Credit

- **Consensus view:** Credit spreads stay high but don't climb very much from recent ranges
- **Risks to the consensus view:** High interest rates for longer and recession could keep pressure on spreads (pressure from two ends!).

Equities

- **Consensus view:** Very mild recession will limit earnings pressure
- **Risks to the consensus view:** Squeeze between recession and interest rates staying high for longer – much the same as credit

Best scenario for markets?

'Soft Landing' – Growth slows but not too much, but enough to take pressure off interest rates

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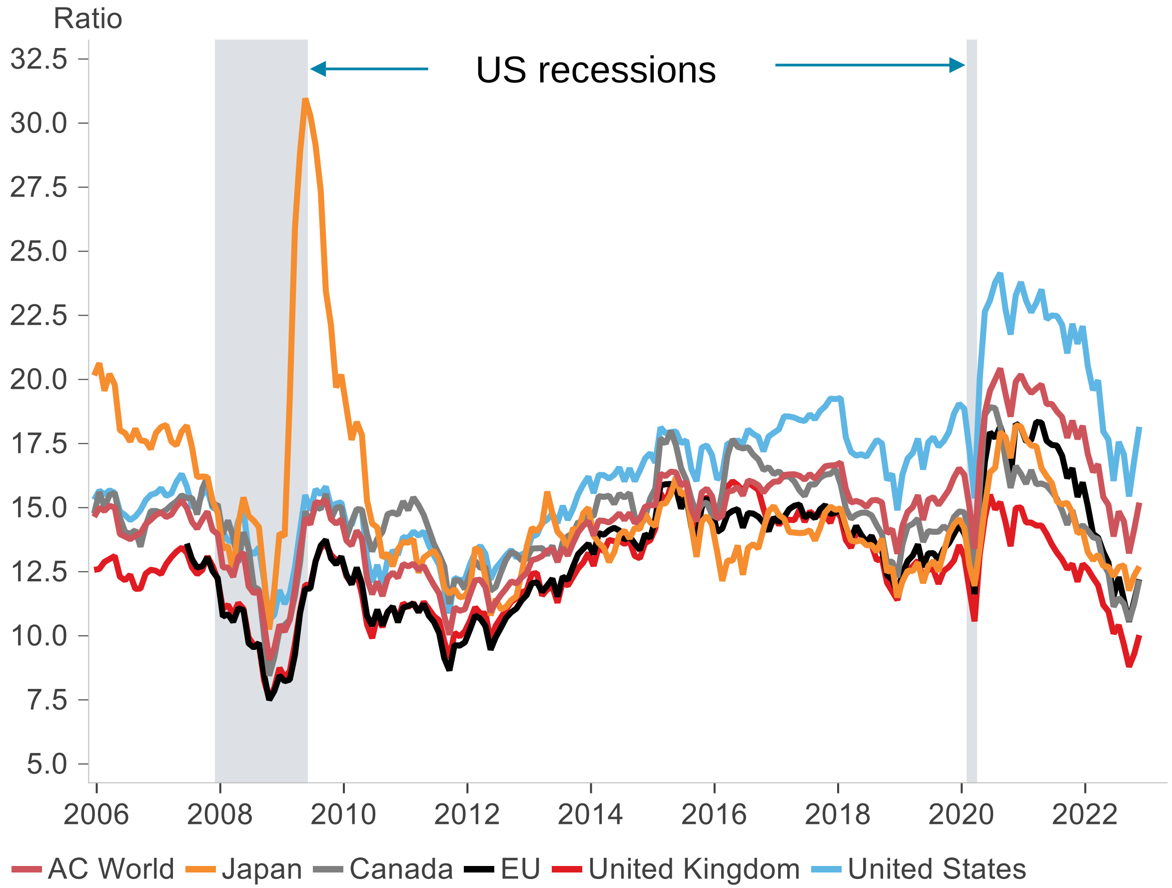
Equity valuations have improved, especially earnings-based measures

Equity Indices, MSCI, IMI (Large, Mid & Small Cap), Index, 12 Month Forward P/E

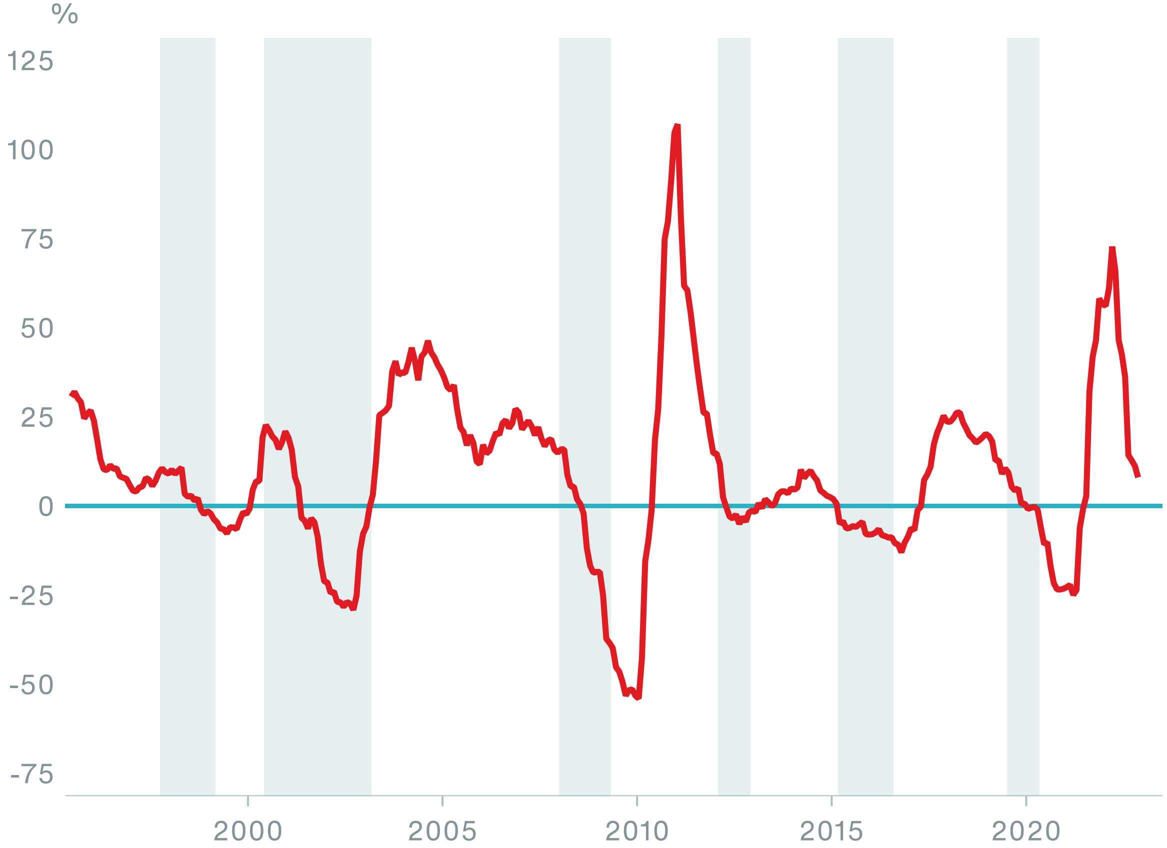


Source: Macrobond

- A very challenging year for equity market returns has resulted in much improved valuations.
- This is especially apparent in earnings-based valuation measures, such as forward and trailing PE ratios.
- The 12m forward PE ratios outside of the US have fallen to or below the lows reached during the pandemic and the GFC.
- We remain cautious, however, as corporate earnings expectations do not reflect a recessionary environment.

Corporate earnings forecasts have been revised lower, but not by enough to reflect a recession

12m growth in earnings per share, shaded areas are G7 recessions

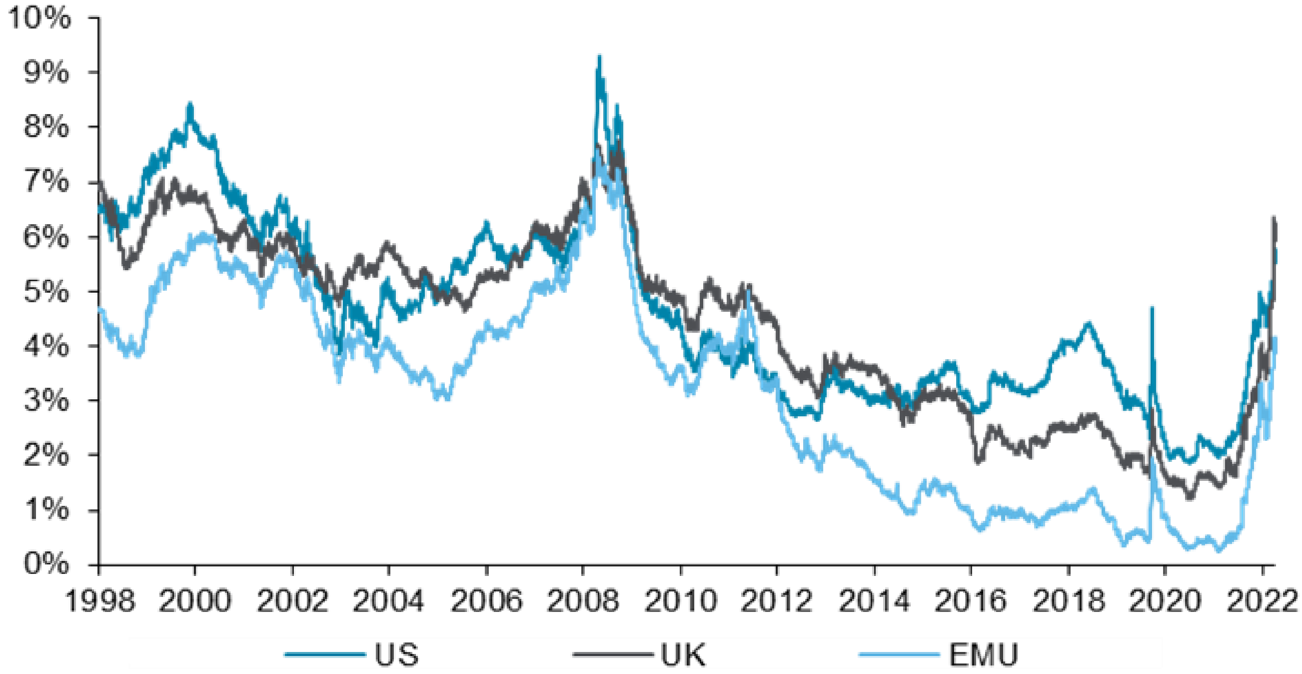


Source: Macrobond

- MSCI World earnings growth forecasts have more than halved this year, but remain at around 4% in 2023 and 2024. These are still relatively healthy expectations, especially if we do see a global recession.
- Earnings growth tends to contract in recessions, sometimes significantly. If this occurs, then current valuation measures will not turn out to be as attractive as some may think.
- Overall, we think that equity valuations are no longer expensive, rather than "cheap".

Investment grade yields have risen sharply but we remain more cautious on high yield bonds

Investment grade bond yields have risen to 2009 levels

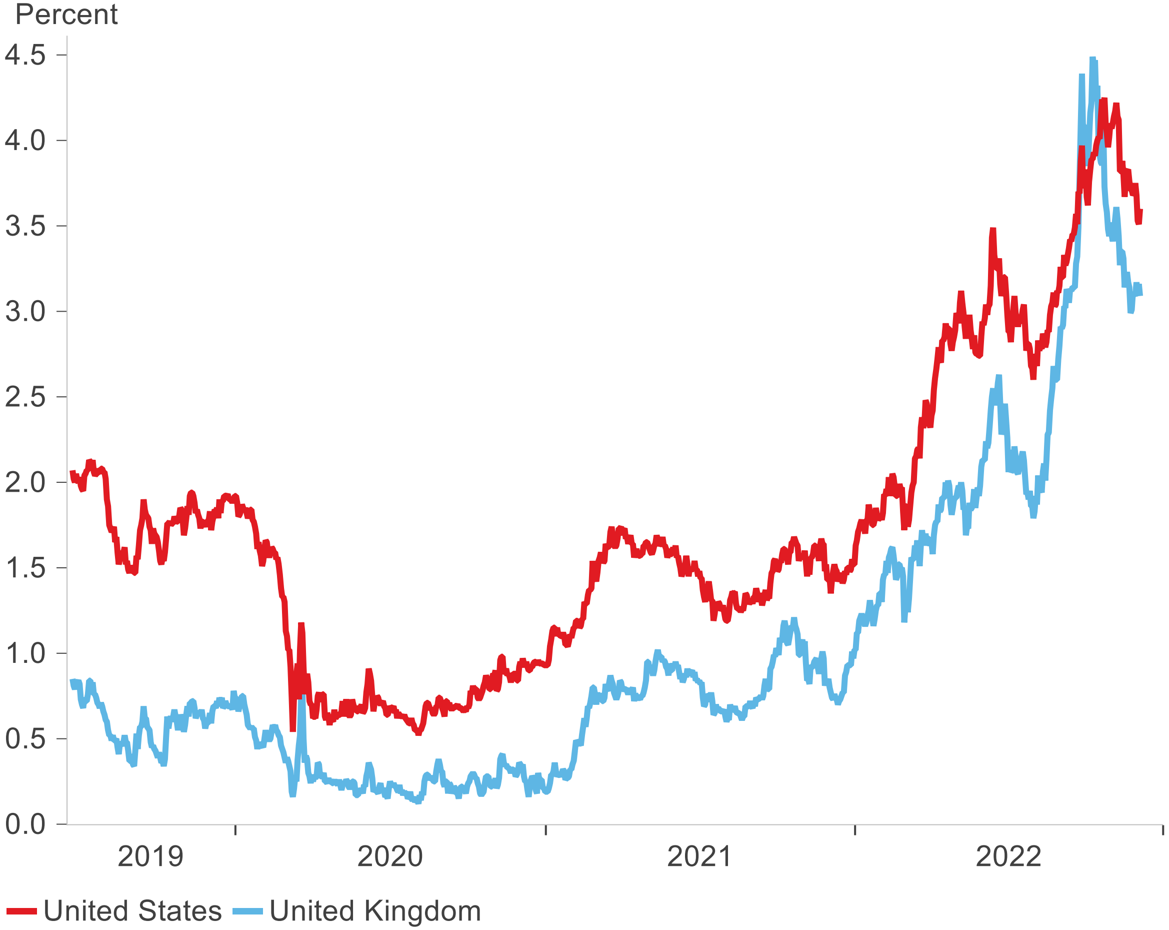


- UK investment grade yields now far exceed their 2020 spike level and are as high as in 2009. This has been driven simultaneously by the strong government bond bear market and rising credit spreads.
- We still think that credit spreads can widen further but current levels provide some cushion for IG credit returns relative to government bonds and we expect that high quality credit demand will start to return.

Source: Macrobond

Government bond yields have come off their peaks but remain much higher than last year

10-year government bond yields

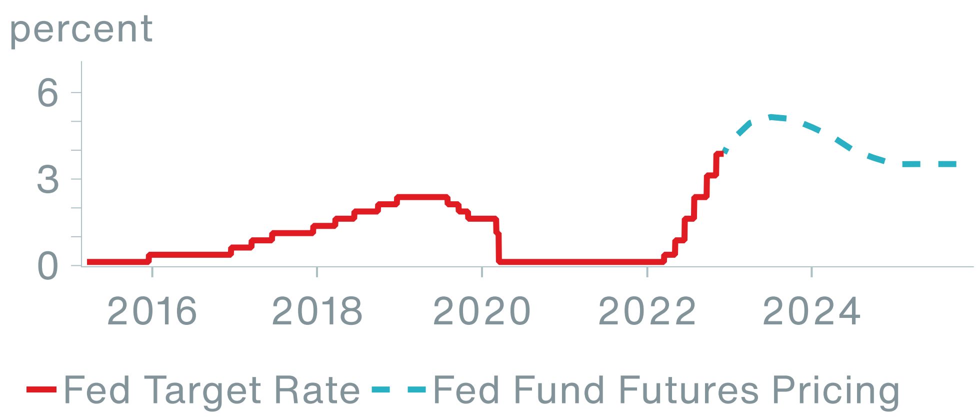


Source: Macrobond

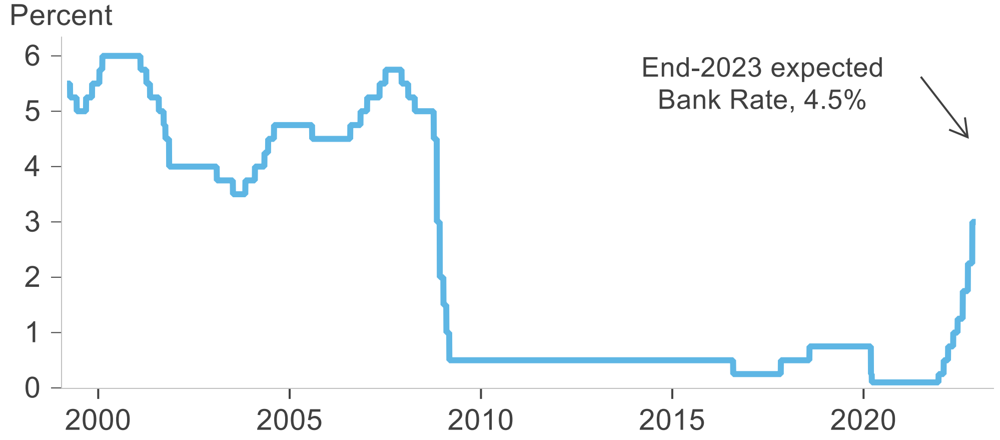
- G7 government bond yields have fallen sharply since the October rally began, on hopes of less monetary policy tightening. Yields remain higher than in 2021.
- Weakening growth may lead to further downward pressure in yields but we suspect high inflation will persist for much of next year, meaning yields are unlikely to fall back to pre-pandemic levels quickly.
- We expect further volatility and risks remain reasonably balanced.

Fed funds rate is expected to peak at 5%, whilst rate cuts are priced in towards the end of 2023

Fed Funds Rate and Market Expectations



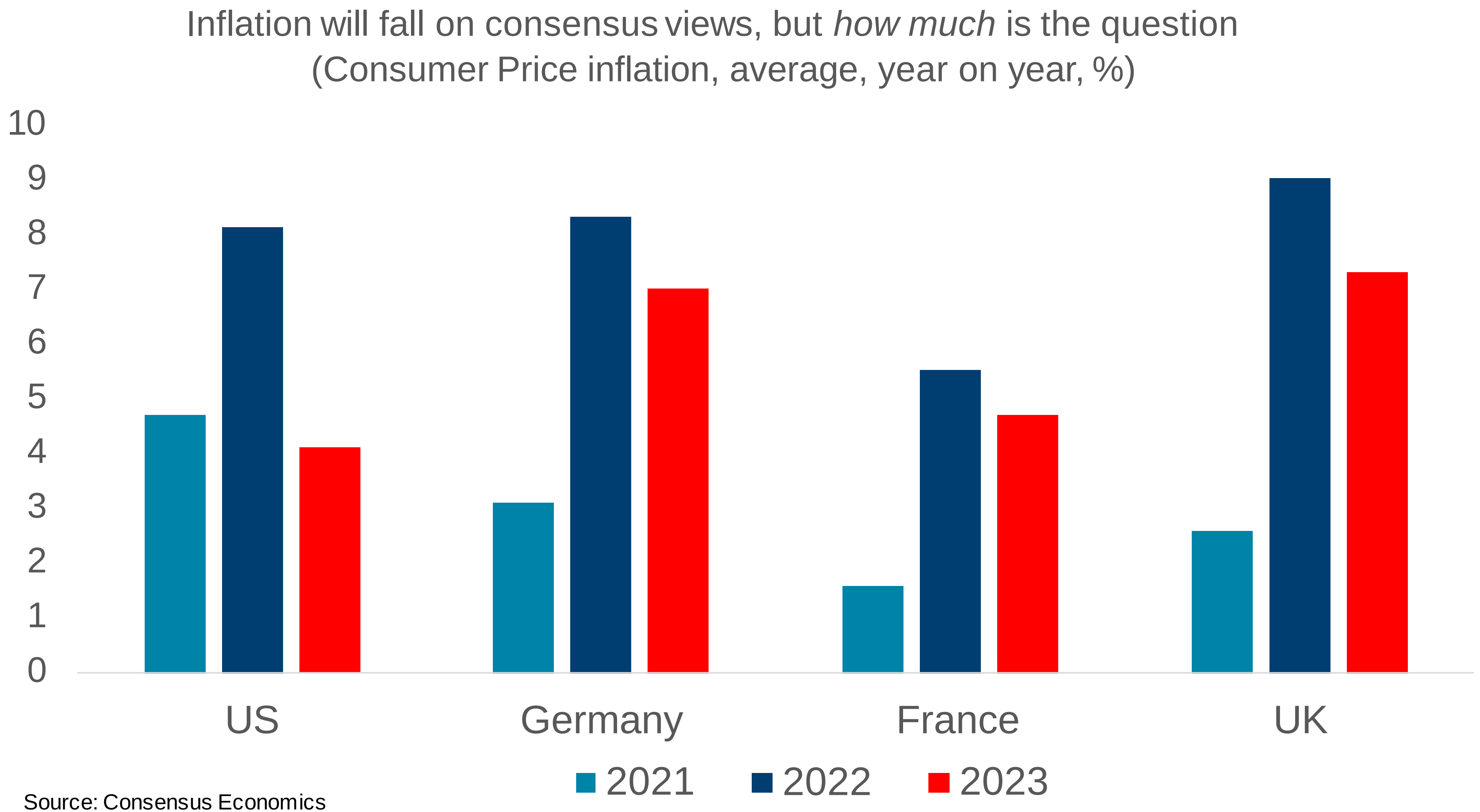
United Kingdom Bank Rate



Source: Macrobond

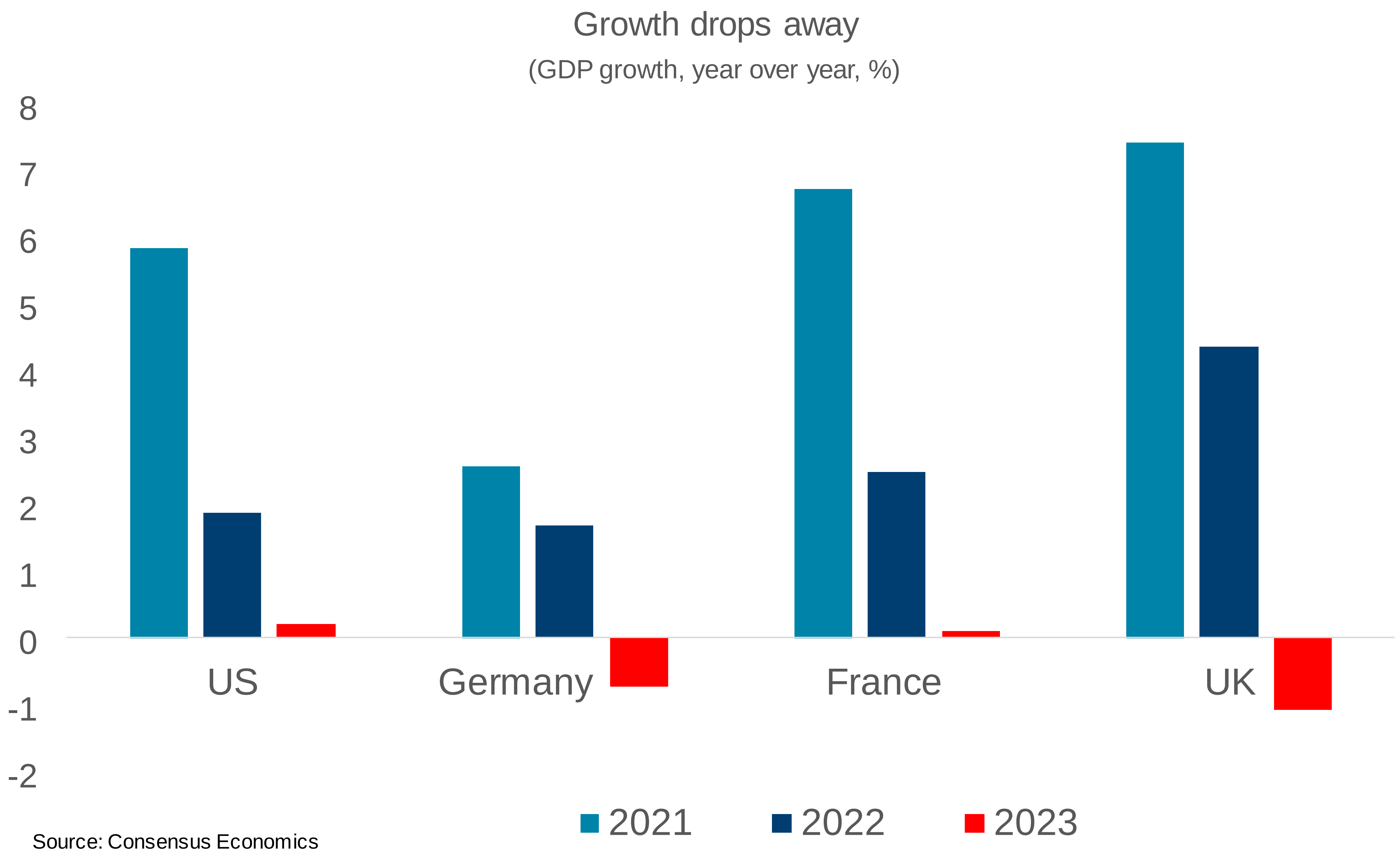
- The US Federal Funds rate is the key driver of asset markets globally and it has reached 3.75% - 4% already. Markets are expecting another 100bps by next summer. UK Bank Rate is expected to reach 4.5% by the end of 2023.
- Will this be enough tightening?
- By the end of 2023, rate cuts are expected in the US, not in the UK, which implies that the US will be in a recession by then. If inflation remains elevated, rate cuts might be off the table.

The inflation problem – consensus view



Source: Consensus Economics

The growth shortfall – consensus view



Source: Consensus Economics

Fund Valuation

Fund Valuation – 31 October 2022

	30 September 2022		31 October 2022		
	£m	%	£m	%	Strategic
Equities	**533.5**	**37.0**	**549.6**	**37.9**	**35.0**
BlackRock World Low Carbon	236.9	16.4	242.4	16.7	
Trilogy Global Unconstrained	0.8	0.1	0.8	0.1	
MFS Global Unconstrained	67.3	4.7	74.2	5.1	
London CIV Baillie Gifford	97.2	6.7	96.2	6.6	
London CIV JP Morgan	30.3	2.1	28.2	1.9	
London CIV Longview Partners	101.0	7.0	107.8	7.4	
Private Equity	**122.4**	**8.5**	**118.1**	**8.1**	**5.0**
Adams Street	122.4	8.5	118.1	8.1	
Hedge Funds	**76.9**	**5.3**	**75.0**	**5.2**	**0.0**
York Distressed Securities	3.8	0.3	3.3	0.2	
Davidson Kempner International	37.7	2.6	36.2	2.5	
CFM Stratus	35.3	2.4	35.6	2.5	
UK Property	**93.3**	**6.5**	**88.1**	**6.1**	**5.0**
Blackrock	41.0	2.8	38.8	2.7	
Legal & General	42.8	3.0	39.6	2.7	
Brockton	9.5	0.7	9.8	0.7	
PFI & Infrastructure	**71.2**	**4.9**	**70.5**	**4.9**	**16.0**
IPPL Listed PFI	45.0	3.1	44.9	3.1	
Antin	26.2	1.8	25.6	1.8	
Bonds	**277.7**	**19.2**	**281.9**	**19.4**	**24.0**
BlackRock Passive Gilts and ILGs	79.7	5.5	79.5	5.5	
Western Active Bonds	69.2	4.8	73.8	5.1	
Insight Absolute Return Bonds	31.9	2.2	31.6	2.2	
London CIV Multi-Asset Credit	50.4	3.5	50.7	3.5	
Diversified Liquid Credit	46.6	3.2	46.3	3.2	
Alternative fixed income	**75.0**	**5.2**	**75.0**	**5.2**	**5.0**
London CIV Global Bond Fund	75.0	5.2	75.0	5.2	
Inflation protecting illiquids	**113.3**	**7.8**	**112.0**	**7.7**	**10.0**
M&G Inflation Opportunities	66.7	4.6	65.5	4.5	
CBRE	46.6	3.2	46.6	3.2	
Cash	**80.5**	**5.6**	**80.6**	**5.6**	**0.0**
Enfield Cash	80.5	5.6	80.6	5.6	
Total Assets	**1443.8**	**100.0**	**1450.8**	**100.0**	**100.0**

Source: Northern Trust. Total might not sum due to rounding. Some valuations may be lagged.
Accounts for £75m from MFS Global Equity to LCIV Global Bond Fund.

Appendix

Aon plc (NYSE:AON) exists to shape decisions for the better - to protect and enrich the lives of people around the world. Our colleagues provide our clients in over 120 countries with advice and solutions that give them the clarity and confidence to make better decisions to protect and grow their business.

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