Independent Adviser's Report

Quarterly Report

Q3 2024

Table of Contents

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Adviser’s Report

FUND PERFORMANCE (REFERS TO BRUNEL REPORT IN YOUR PAPERS)

- **FLASH UPDATE: The Mansion House Speech by the Chancellor on November 14th contained important news about the future of the LGPS. I will address these issue verbally at the Committee Meeting.**

- **Dorset performance was +2.1% and ahead of benchmark in Q3 2024**. 1 year performance is in line with benchmark but lags over all other periods.

  My past quarterly reports have dwelt at length on the poor investment performance versus benchmark of the Brunel Pool and the “headwinds” they have faced, so it is good to see a better quarter. The **drivers of the better performance this quarter were in the areas of Multi Asset Credit, Sterling Corporate Bonds and UK Active Equities**. Having some strategic currency hedging in place at a time of £ strength was also be helpful to the overall performance.

  As the Brunel Dorset client report points out, Q3 saw a great deal of internal volatility within equity sectors. Technology fell sharply then recovered. Growth and Quality performed poorly, and Brunel has a bias towards these sectors. Brunel comment that their Value Managers performed better. These style factors within the many equity portfolios are somewhat problematic I believe, and Brunel is not addressing the matter sufficiently in my opinion. Brunel’s portfolios have a Growth and Quality bias, but this is at the cost of underweighting “Value”. Of course, our pension fund needs capital growth from our equity portfolios, but I believe that doesn’t have to be achieved only by holding perceived growth stocks. Many such expectations of future growth can falter as companies fail to make their growth predictions, whereas instead such appreciation could be achieved via “growth at a reasonable price” or via income stocks. Thus, growth of investment returns could be achieved by paying more attention to the valuation of stocks at the point of investment. Simply put, valuation matters. Picking apart the second point, “Quality” has many definitions, and although there is much to be said for investing in quality, there is many a slip twixt cup and lip in the implementation of the style factor. Overall, I would like to see Brunel pay more attention to Value and Valuations as factors in the equity portfolios of their underlying managers. If this poses a problem relating to Responsible Investing, then Brunel still need to figure out how to navigate that in order to deliver client performance expectations. So far, they have not been able to do this, and so they should be challenged on these points.

- David Vickers, the Chief Investment Officer of Brunel has resigned and will be leaving to pastures new in the spring of 2025. As the most senior investment figure at Brunel this is clearly an important position. He has been at Brunel for four years, and I am sorry to see him depart, despite all my expressed reservation about the investment performance of Brunel. David is a good communicator and has been very client-friendly, so we wish him well. Appointing a replacement poses an interesting challenge for Brunel at a time when there is some government pressure for pools to consolidate and there be fewer pools. This creates job and career uncertainty for the individuals who work for Pools. Governance at Brunel has been calm in the last couple of years, but now with a newly appointed Chair and David resigning we need to play our part in supporting Brunel so that it is in a fit state for the next few years.

- The recent UK budget had some interesting pensions developments beyond the obvious changes to NI and Inheritance Tax. The government has introduced a new measure called the “Public Sector Net Financial Liabilities” which now includes the assets and the liabilities of the LGPS, and by doing so allows for some extra UK borrowing via gilt issuance. The LGPS overall is in surplus, so it is likely the surpluses/deficits will come under more central government scrutiny. What could that mean in practice? LGPS funds which have achieved surplus, as the majority have, may feel under pressure not to fall back into deficit by maintaining Employer contributions at higher levels than they might have been under the previous PSBR regime. Or they might be tempted to “de-risk” their portfolios. We are not in this position yet.
- A further talking point in LGPS circles is the Chancellor’s Mansion House speech which will be delivered on November 14th, after the time of writing my report. I will brief the Committee verbally at the meeting on the 26th.
- As of the time of writing, the US elections have resulted in a sweeping victory for Trump. Initial market movements have been unsurprising…the dollar has risen, US government bonds have fallen, equities have risen, non-US markets, particularly Emerging markets have fallen. The markets are concerned about increased US borrowing and trade barriers. I am concerned that the Brunel portfolios are not well positioned for the initial sector moves in response to the Trump election and I will be happy to say more on this at the Committee meeting, by which time things may have settled somewhat. How the Trump Presidency mark 2 behaves is unpredictable, but it does nothing to change the reservations I have about increased volatility and the need to diversify our US exposure.

INVESTMENT STRATEGY

- As reported in the last quarter, our Investment Strategy is in good shape. However, I am seriously concerned about the over-concentration of the global equity markets, and I believe the expected return from equities is going to be more challenging in the next few years. I have explained the background to this view in previous training and committee sessions. So, I have written a paper recommending one change to our allocation within equities. This is just one step. We need to come forward with further recommendations in order to position ourselves for the future.

Economic and Market Commentary

- Q3 2024 saw cooling inflation and the subsequent easing of monetary policy across developed markets, most notably the Federal Reserve's 50bps rate cut in September. The Bank of Japan was the only major central bank to buck this trend, and the surprise rate increase in August saw a sharp rise in the JPY which combined with weaker US employment data and concerns over AI valuations, leading to a sharp selloff. Markets recovered quickly however, as reassuring growth data (quarterly real GDP growth of 0.5%, 0.2% and 0.7% across the UK, Eurozone and US) combined with easing inflation to reduce fears of a recession and raise the prospect of further rate cuts. Leading economic indicators remain generally positive, while manufacturing purchasing mangers' indices (PMIs) weakened through the quarter, showing slight contractions except in the UK, services PMIs remain in positive territory in most regions, notably in the US (55.4).
- Global markets delivered strong positive returns for most major asset classes in Q3, as interest rates decreased and expectations for further cuts grew. Global equities gained 6.4%, with all developed regions staying positive except Japan, though the strengthening yen meant positive returns in GBP terms. EM equities rallied into the end of the quarter, led by China following a raft of stimulus measures announced in September, ultimately delivering 8.7% returns. The US continued to outperform Europe with the S&P500 up 5.9%. UK and Eurozone returns were more muted, posting 2.3% and 2.4% gains respectively. Value outperformed growth by 7%, with small-cap stocks also advancing. Fixed income also benefitted from rate cuts and was led by emerging markets. Corporate debt saw healthy returns with regional performance between the US, Eurozone and UK broadly on par with the performance of respective equities markets. Commodities were mixed, with Brent Crude falling -17% on increased output expectations and lower demand despite geopolitical tension in the Middle East. Natural Gas continued to outperform (+12.4%) and Gold rallied 12.7% to all-time highs. The Pound strengthened 5.8% on the dollar and 1.8% on the Euro. The Yen appreciated 10.7% versus the Dollar.

We highlight the following themes impacting investment markets:

- **Cooling inflation and interest rate cuts – but no return to "free money":** with energy prices falling and services wages coming under control, inflation is no longer constraining central banks, so markets are expecting interest rate cuts to continue over the next 1-2 years. But the structural factors underpinning inflation remain (demographics, de-globalisation, de-carbonisation of energy), and so our expectation would be to remain in a world of c.2-3% inflation.

- **Elevated volatility characteristic of inflection points:** The VIX volatility measure increased to 17 from 12, with equities experiencing significant volatility in early August, as traders who had (on average) used borrowed Yen to buy US assets including highly valued US tech stocks, closed these positions. Chinese equity markets, having underperformed significantly over the last year, similarly bounced some 20% on the back of the recent stimulus measures. This kind of volatility is symptomatic of markets with pockets of excess or at times of change. Investors should consider their allocation to diversifiers and think hard about any unintended concentrations of risk in their portfolios.

- **Geopolitical risk rises but impacts so far muted:** The Middle East saw a significant increase in geopolitical tension as Israel initiated bombing campaigns in Lebanon (subsequently killing the leader of Hezbollah) and continued its activity in Gaza.

- Global equities rose 6.4% in Q3 (YTD: +18.9%) largely on the back of easing monetary policy and revised forward rate expectations. There was heightened volatility midway through the quarter due to a surprise rate hike from the BoJ and mixed US economic data. Ultimately the Fed's decision to cut interest rates by 50bps in September led US stocks to rally, delivering a positive return for the quarter (S&P 500: +5.9%). We note value stocks outperformed growth, although the 'Magnificent 7' continued to deliver positive returns (+4.0%) despite the strong performance YTD (+60.4%), and still represent more than 30% of the US stock market. The VIX increased to 17 from the 12-13 range we have seen over the past 12 months as a result of the August selloff and uncertainty heading into a more close-run US election following Joe Biden's withdrawal.
  - In the US, the total return of the S&P500 was 5.9% (YTD: +22.1%).
  - The EuroStoxx 50 total return was 2.4% (YTD: +13.1%), with Eurozone stock returns led by real estate, utilities and healthcare.
  - In the UK, the FTSE all-share total return was 2.3% (YTD: +9.9%) and alongside the FTSE100 reached all-time highs.
  - The Nikkei 225 total return was -3.5% (YTD: +15.2%), with Japan the only major developed region to see negative returns amid historically high volatility, driven by heightened volatility of the yen.
  - Emerging markets equities total return was 8.7% (YTD: +16.9%), led by Asia (ex-Japan), notably Thailand and China (where the Shanghai Composite index rose 23% in the final 2 weeks of the quarter, following a raft of government stimulus measures).
- Yields fell as the rate cutting cycle began across many major economies, the most notable of which being the Fed's 50bps cut, in-part motivated by rising unemployment.
  - The US 10-year yield fell from 4.4% to 3.8% following a 50bps cut led by rising unemployment and falling inflation.
  - The Euro 10-year composite yield fell from 2.5% to 2.1%, with a 25bps cut in September and amid concerns over sluggish growth. Notably, France's borrowing costs now exceed those of Spain due to concerns over its fiscal position.

- The UK 10-year Gilt yield fell from 4.2% to 4.0%, reflective of hawkish commentary on the prospect of future easing. Since quarter end, gilt yield has been rising at the time of the UK budget

Key Indicators at a Glance

	Index (Local Currency)	Q3	YTD
Equities		**Total Return**	
UK Large-Cap Equities	FTSE 100	1.82%	9.83%
UK All-Cap Equities	FTSE All-Share	2.26%	9.85%
US Equities	S&P 500	5.89%	22.08%
European Equities	EURO STOXX 50 Price EUR	2.39%	13.08%
Japanese Equities	Nikkei 225	-3.50%	15.16%
EM Equities	MSCI Emerging Markets	8.72%	16.86%
Global Equities	MSCI World	6.36%	18.86%
Government Bonds			
UK Gilts	FTSE Actuaries UK Gilts TR All Stocks	2.32%	-0.23%
UK Gilts Over 15 Years	FTSE Actuaries Uk Gilts Over 15 Yr	2.64%	-3.75%
UK Index-Linked Gilts	FTSE Actuaries UK Index-Linked Gilts TR All Stocks	1.42%	-2.49%
UK Index-Linked Gilts Over 15 Years	FTSE Actuaries UK Index-Linked Gilts TR Over 15 Yr	1.53%	-5.89%
Euro Gov Bonds	Bloomberg EU Govt All Bonds TR	4.03%	1.95%
US Gov Bonds	Bloomberg US Treasuries TR Unhedged	4.74%	3.84%
EM Gov Bonds (Local)	JP. Morgan Government Bond Index Emerging Markets Core Index	8.56%	4.61%
EM Gov Bonds (Hard/USD)	JP. Morgan Emerging Markets Global Diversified Index	6.15%	8.64%
Bond Indices			
UK Corporate Investment Grade	S&P UK Investment Grade Corporate Bond Index TR	2.35%	2.22%
European Corporate Investment Grade	Bloomberg Pan-European Aggregate Corporate TR Unhedged	3.44%	4.16%
European Corporate High Yield	Bloomberg Pan-European HY TR Unhedged	3.65%	7.00%
US Corporate Investment Grade	Bloomberg US Corporate Investment Grade TR Unhedged	5.84%	5.32%
US Corporate High Yield	Bloomberg US Corporate HY TR Unhedged	5.28%	8.00%
Commodities			
Brent Crude Oil	Generic 1st Crude Oil, Brent, USD/bbl	-16.94%	-6.84%
Natural Gas (US)	Generic 1st Natural Gas, USD/MMBtu	12.38%	16.27%
Gold	Generic 1st Gold, USD/toz	12.67%	27.24%
Copper	Generic 1st Copper, USD/lb	3.70%	17.03%
Currencies			
GBP/EUR	GBPEUR Exchange Rate	1.79%	4.14%
GBP/USD	GBPUSD Exchange Rate	5.77%	5.06%
EUR/USD	EURUSD Exchange Rate	3.94%	0.87%
USD/JPY	USDJPY Exchange Rate	-10.72%	1.84%
Dollar Index	Dollar Index Spot	-4.81%	-0.55%
USD/CNY	USDCNY Exchange Rate	-3.42%	-1.15%
Alternatives			
Infrastructure	S&P Global Infrastructure Index	13.37%	17.92%
Private Equity	S&P Listed Private Equity Index	12.32%	21.41%
Hedge Funds	Hedge Fund Research HFRI Fund-Weighted Composite Index	1.67%	8.06%
Global Real Estate	FTSE EPRA Nareit Global Index TR GBP	9.59%	6.84%
Volatility		**Change in Volatility**	
VIX	Chicago Board Options Exchange SPX Volatility Index	34.49%	34.38%

Source: Bloomberg. All return figures quoted are total return, calculated with gross dividends/income reinvested.

Charts and Data

Economic Indicators

Table 1: Quarterly Real GDP Growth and Monthly CPI

%	GDP		CPI		
	Q2 2024	**Q3 2024**	**Jul**	**Aug**	**Sep**
UK	0.5	-	2.2	2.2	-
US	0.7	-	2.9	2.5	-
Eurozone	0.2	-	2.6	2.2	-
Japan	0.7	-	2.8	3.0	-

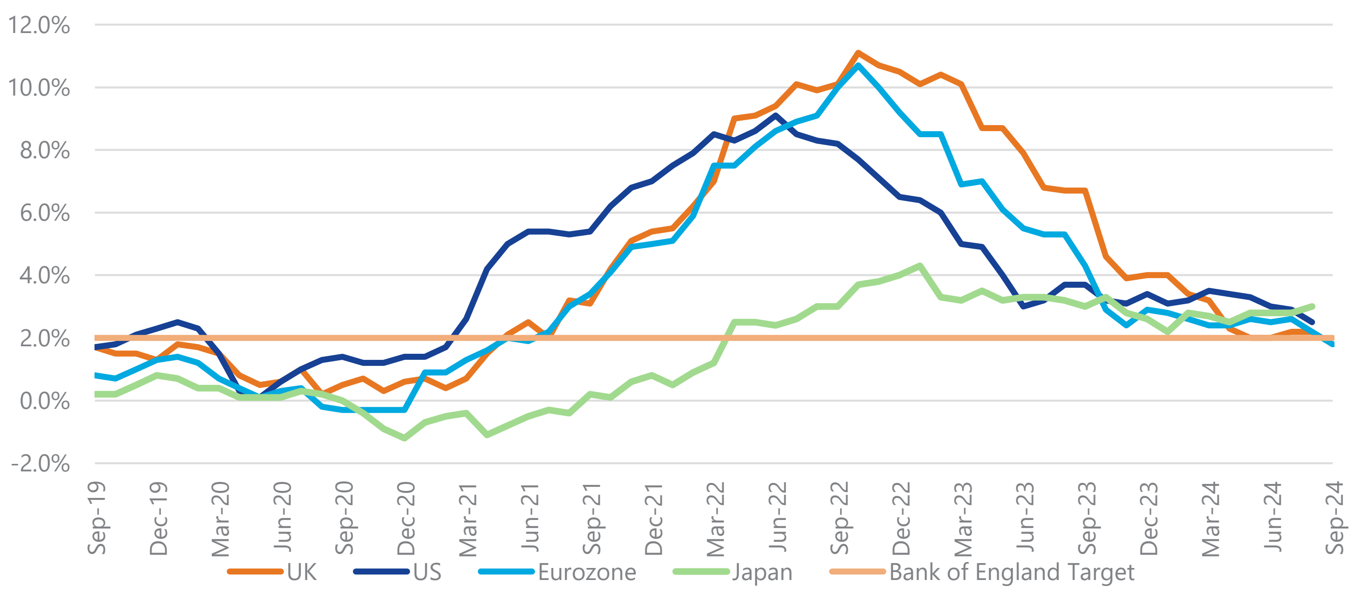
Source: Bloomberg; Trading Economics.

Notes: * Not available at time of publication; ** Forecasts based on leading indicators (*not available at time of publication this quarter*)

CPI: UK: UK CPI EU Harmonised YoY NSA (Ticker: UKRPCJYR Index); US: US CPI Urban Consumer YoY NSA (Ticker: CPI YOY Index); Eurozone: Eurostat Eurozone MUICP All Items YoY Flash Estimate (Ticker: ECCPEST Index); Japan: Japan CPI Nationwide YOY (Ticker: JNCPIYOY Index)

GDP: UK Real GDP (Ticker: UKGRABIQ Index), US Real GDP (Ticker: GDP CQOQ Index) de-annualised, Eurozone Real GDP (Ticker: EUGNEMUQ Index), Japan Real GDP (Ticker: JGDPQGDP)

Chart 1: CPI – Annual rate of Inflation - Five Years to September 2024

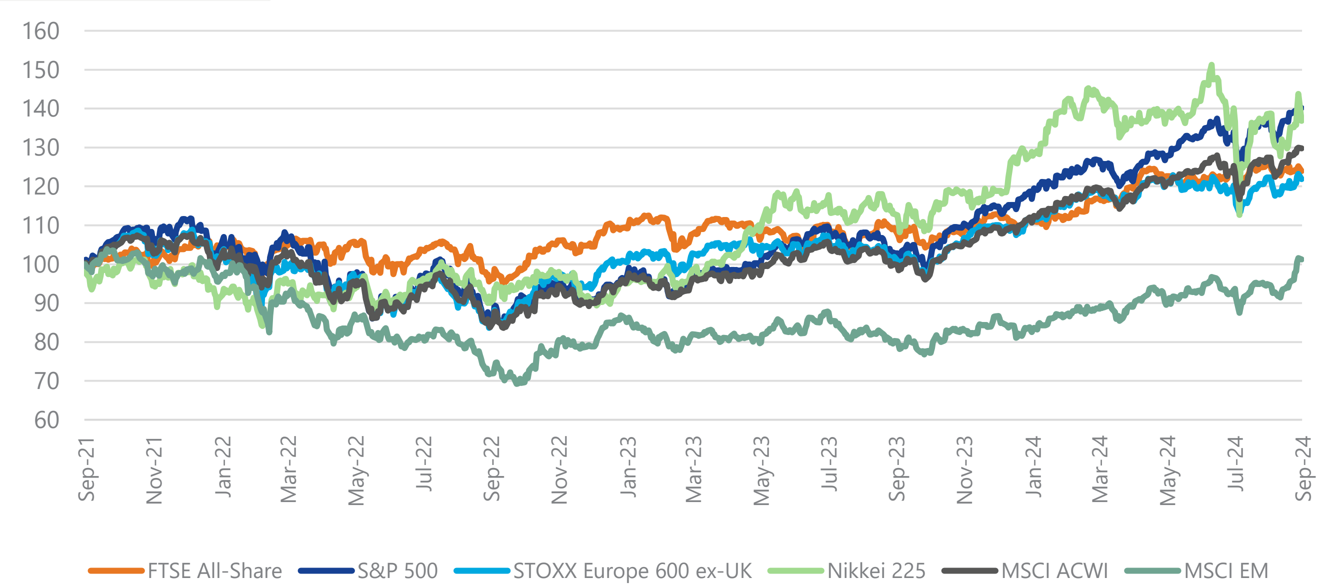


Source: Bloomberg

Notes: UK: UK CPI EU Harmonised YoY NSA (Ticker: UKRPCJYR Index); US: US CPI Urban Consumer YoY NSA (Ticker: CPI YOY Index); Eurozone: Eurostat Eurozone MUICP All Items YoY Flash Estimate (Ticker: ECCPEST Index); Japan: Japan CPI Nationwide YOY (Ticker: JNCPIYOY Index)

Equities

Chart 2: Global Equity Markets Performance



Source: Bloomberg. All in local currencies

Notes: FTSE All-Share Index (Ticker: ASXTR Index); S&P 500 Index (Ticker: SPXT Index); STOXX Europe 600 (Ticker: SXXG Index); Nikkei 225 Index (Ticker: NKYTR Index); MSCI World Index (Ticker: DLEACWF Index); MSCI Emerging Markets (Ticker: M1EF Index)

Chart 3: Global Equity Markets, Growth vs Value

Source: Bloomberg

Notes: MSCI World Value Index (Ticker: MXWO000V Index); MSCI World Growth Index (Ticker: MXWO000G Index)

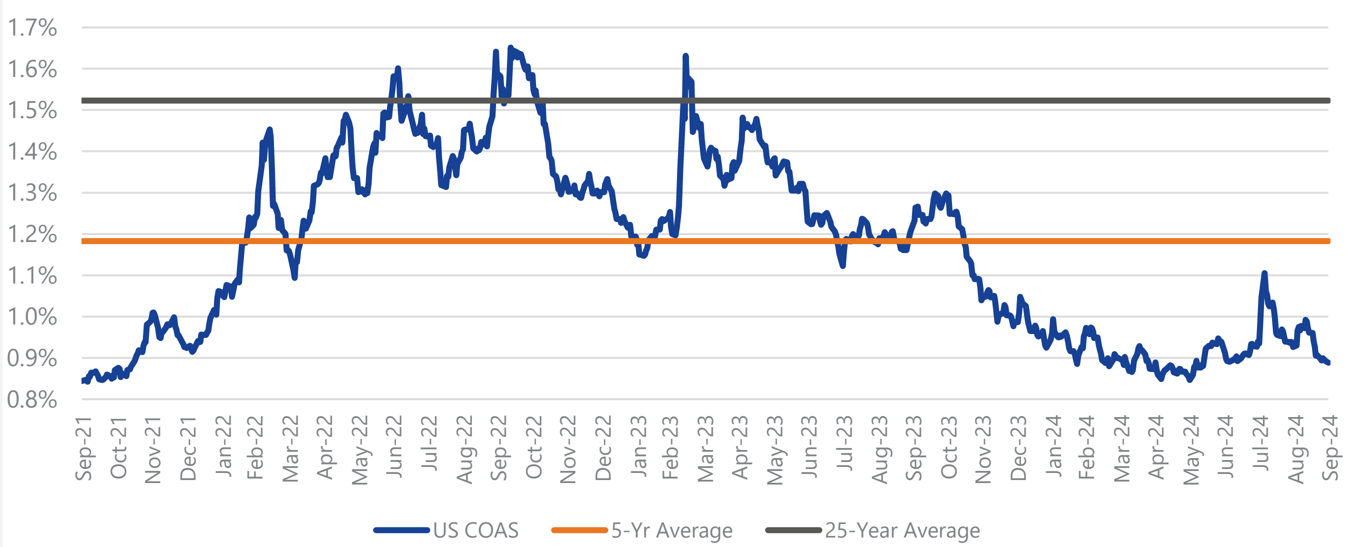
Table 2: MSCI ACWI Composition

Region	Q2 2024 (%)	Q3 2024 (%)
US	64.8	64.3
UK	3.4	3.4
Europe (ex-UK)	11.5	11.4
Japan	5.3	5.2
Developed Asia-Pacific	2.6	2.7
Emerging Markets	9.6	10.1
Other	2.8	3.0

Source: iShares MSCI ACWI ETF

Fixed Income

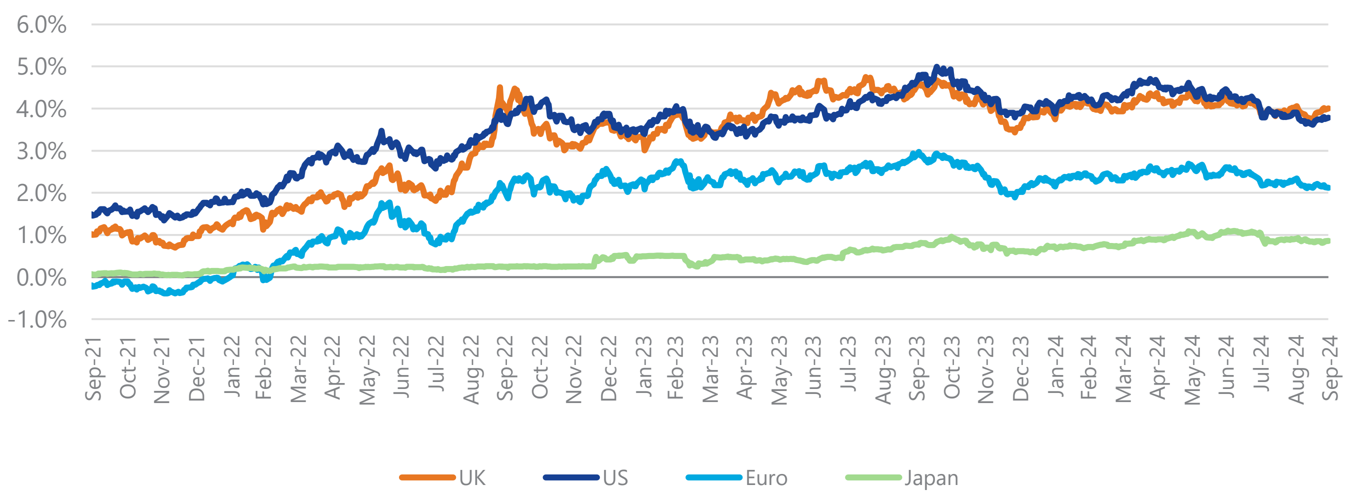
Chart 4: US Corporate Bond Spreads



Source: Bloomberg

Notes: Bloomberg Barclays US Corporate Option Adjusted Spread (Ticker: LUACSTAT Index); Option-Adjusted Spreads (OAS) represent the difference between the index yield and the yield of a comparable maturity treasury

Chart 5: Government Bond Yields

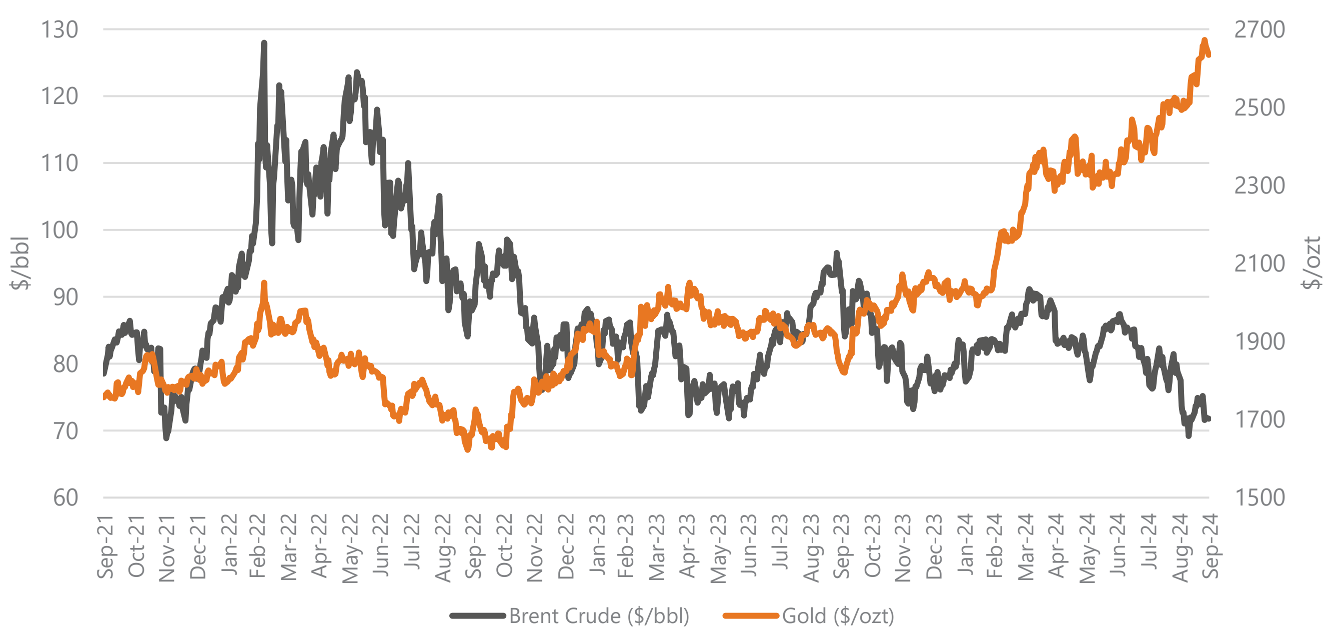


Source: Bloomberg

Notes: US Generic Govt 10 Year Yield (Ticker: USGG10YR Index); UK Govt Bonds 10 Year Note Generic Bid Yield (Ticker: GUKG10 Index); Euro Generic Govt Bond 10 Year (Ticker: GECU10YR Index); Japan Generic Govt Bond 10 Year Yield (Ticker: GJGB10 Index)

Commodities

Chart 6: Gold and Brent Crude Oil Prices

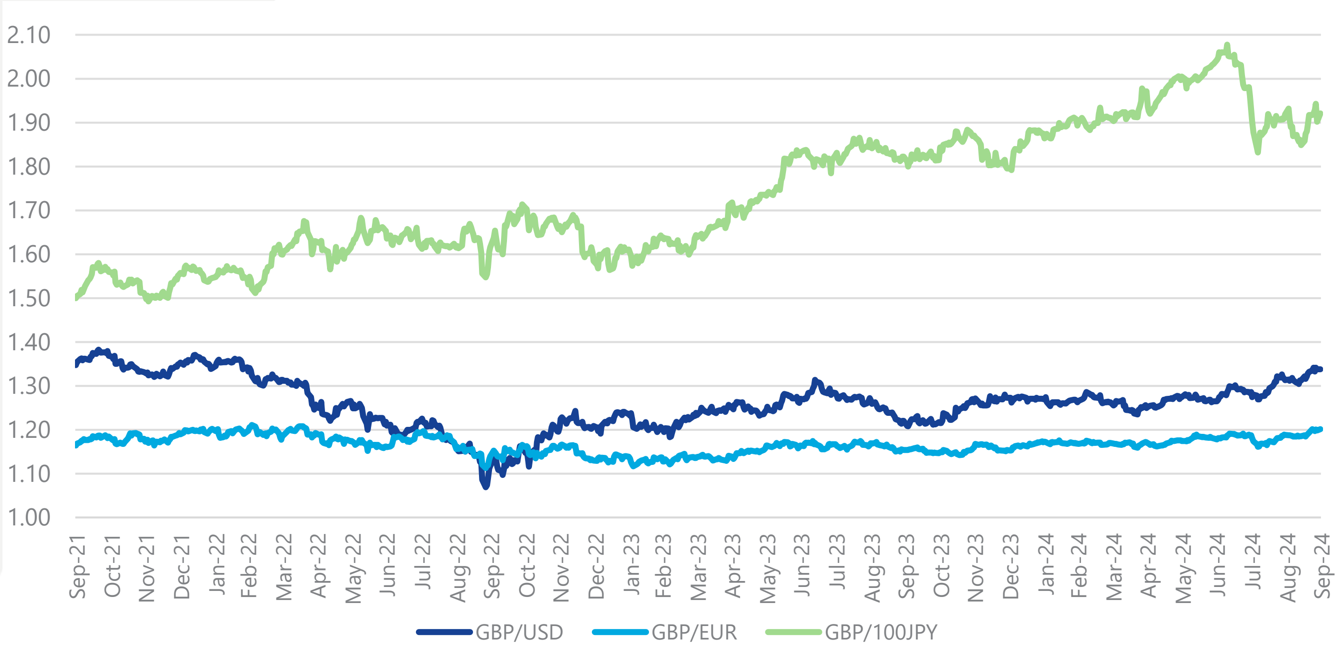


Source: Bloomberg

Notes: Gold USD Spot (Ticker: XAU Currency); Generic 1st Brent Crude Oil (Ticker: CO1 Commodity)

Currencies

Chart 7: Three-Year Currency Rates of Major Currencies vs Pound Sterling



Source: Bloomberg

Notes: GBPEUR Spot Exchange Rate (Ticker: GBPEUR Currency); GBPUSD Spot Exchange Rate (Ticker: GBPUSD Currency); GBPJPY Spot Exchange Rate (Ticker: GBPJPY Currency)

Table 3: Currency Rates as of 30 September 2024

Pair	Q3 Value	% Change Over Quarter
GBP/EUR	1.2012	1.79%
GBP/USD	1.3375	5.77%
EUR/USD	1.1135	3.94%
USD/JPY	143.63	-10.72%

Source: Bloomberg

Notes: GBPEUR Spot Exchange Rate (Ticker: GBPEUR Currency); GBPUSD Spot Exchange Rate (Ticker: GBPUSD Currency); EURUSD Spot Exchange Rate (Ticker: EURUSD Currency); USDJPY Spot Exchange Rate (Ticker: USDJPY Currency)