

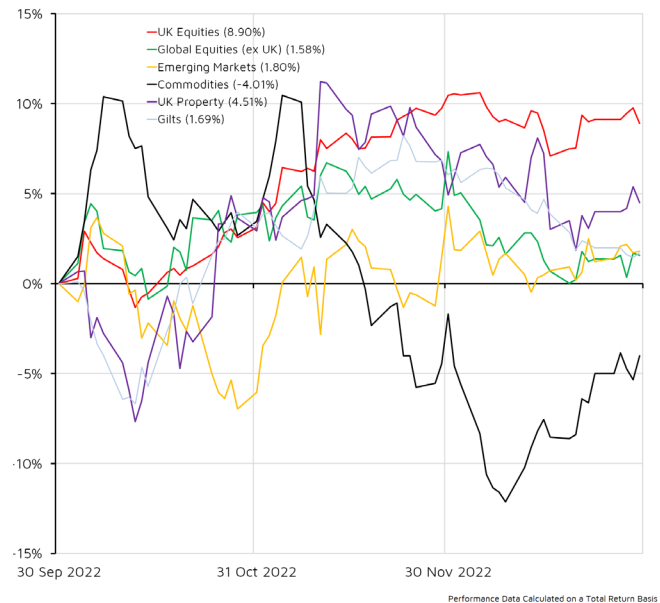


REVIEW OF THE PAST QUARTER:

The last quarter followed the same pattern the previous three as inflation and central bank interest rate decisions dominated markets. Encouraging inflation data raised hopes that inflation is peaking as price rises in the UK, US and Europe showed the first signs of slowing down.

Central banks continued to raise interest rates, but the pace has begun to slow. In December, the US Federal Reserve, the Bank of England and the European Central Bank all increased rates by 0.5% - down from 0.75% at previous decisions. Markets have been looking for clues about when central banks will pause or even reverse recent rate hikes. As economic data continued to deteriorate markets started looking to the rising chance of recession - for the UK there is general acceptance it is already here - as a reason for central banks to change course.

Equities and bonds rose in value and clawed back some of the losses from the first half of the year, although volatility remained a feature of most markets. Central banks have been warning about underestimating their determination to keep monetary conditions tight in order to control inflation. Developed equities have been more receptive to this message as markets fell over the course of December, despite smaller interest rate hikes. Emerging market equities gained as Chinese markets have benefitted from the country abandoning its strict zero-Covid policy.



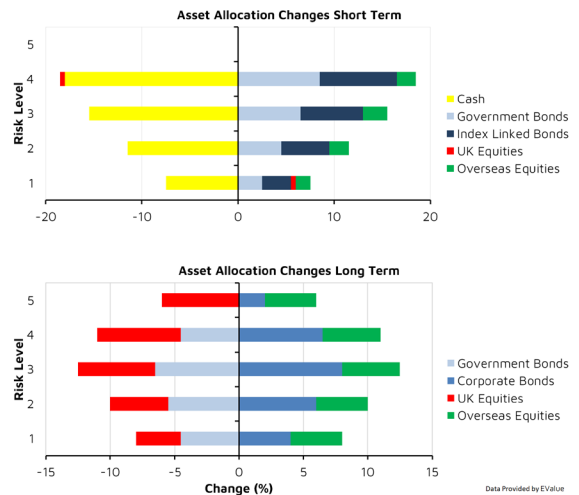
ASSET CLASS RETURNS

Cash	Government Bonds	Index Linked Bonds	Corporate Bonds	UK Equities	Overseas Equities	Emerging Markets	Property
+0.63%	+1.69%	-6.02%	+6.20%	+8.90%	+1.58%	+1.80%	+4.51%

THE ACTUARIAL VIEW:

Higher interest rates mean higher expected returns in general. Relatively strong recent US equity performance gave space for faster rebounds in other markets and so prospects for US asset growth have risen less than most other developed markets. Fears that Chinese growth is slowing have dampened expectations for Asian equities and emerging markets but that was, to an extent, compensated for by recent weakness. UK equity fundamentals have not kept up with other developed markets. Despite a rough quarter, prices remain strong so the outlook for UK equities has fallen behind by other developed markets. European and Japanese equity markets managed to avoid being overtaken by their fundamentals so their outlooks have, relatively, gained the most.

Bonds are now much cheaper, notably with longer-term yields more or less keeping up with movements in shorter-term yields. That means more movement in UK government bonds, which are relatively long dated compared to global government bonds. Property may eventually gain from a higher rate environment but the process of adaptation is risky and the short-term outlook remains bleak.



WHAT TO LOOK FOR:

- UK:** The next Monetary Policy Committee (MPC) announcements and minutes are set to be released on 3 February. Employment data is released on 18 January. Inflation data will be available on 19 January. Consumer confidence and retail sales data to be published on 20 January.
- US:** The next interest rate decision from the Federal Open Market Committee (FOMC) on 1 February; minutes will be published three weeks after each decision. The latest monthly inflation data is released on 12 January. December retail sales data is due out on 18 January. Nonfarm Payrolls expected to be available on 6 January.
- Eurozone:** December GDP inflation data is set to be published on 6 January. The European Central Bank monetary policy meeting is on 2 February. The unemployment rate is set to be published on 9 January.
- Other data:** Chinese balance of trade data is due on 14 January. JPMorgan Global Composite PMI is set to be published on 6 January.

ASSET CLASS SCENARIOS:



UK EQUITY

Most Likely: Inflation remains stubbornly high and the gloomy economic picture deteriorates as the country slides further into recession. Large companies continue to protect their share price and earnings better than small and mid-sized companies. Companies closely tied to consumers will continue to suffer more than less exposed peers such as healthcare, staples and utilities. Banks should continue to be supported in this environment.

Worst Case: Further cuts to Russian gas exports causes energy bills to climb higher. Aggressive interest rate rises cause a deep recession and send stocks and bonds plummeting, accompanied by a rapid increase in unemployment. This culminates in the collapse of an unexpected area of the market leading to a run on the wider market. The UK should be more defensive than other areas, given lower relative valuation levels.

Best Case: Central bank rate hikes cause inflation to fall without affecting unemployment and GDP. From its low valuation base, the UK rebounds further than other markets. A stable government helps to further calm markets unsettled by Liz Truss's premiership. An end to the war in Ukraine helps to further reduce inflation. Flows into UK equities turn positive as smaller companies stand to benefit the most.



GLOBAL EQUITY

Most Likely: Central banks persevere with rate hikes but at a slower pace as inflation begins to slow. Monetary tightening is felt more acutely in the real economy with corporate profits likely to disappoint. Defensive sectors, such as consumer staples and healthcare, outperform alongside quality stocks. Cyclical sectors, like consumer discretionary, are likely to be under pressure.

Worst Case: China's Covid outbreak and housing crisis intensify. Global supply shortages and high inflation forces consumers to dramatically cut discretionary spending as they face a cost-of-living crisis. Central banks keep tightening interest rates and a deep global recession ensues. The global slowdown and rising input costs are likely to trigger a global profit recession, as defensive areas offer better downside protection.

Best Case: Lifting of Chinese Covid restrictions boosts sentiment. As inflation returns to more normal levels, global-recession fears dissipate. The progressive easing of input costs helps protect corporate earnings. Economic growth regains momentum, giving a boost to cyclical sectors such as industrials and consumer discretionary, while growth stocks with high valuations benefit from a stabilisation in monetary policy.



EMERGING MARKET EQUITY

Most Likely: High inflation means countries dependent on external financing could face pressure as the US Federal Reserve maintains high interest rates, leading to a strong dollar. High inflation can be a relative advantage for commodity-producing countries, but there are others, such as India, which are heavily exposed to food imports and could experience economic pressure. China's recent easing of Covid restrictions is positive but the potential impact is not yet clear.

Worst Case: China experiences headwinds from foreign regulation, Covid and a struggling property market. A Chinese invasion of Taiwan would have a material impact on emerging markets, but also has the potential to create a strong economic shock globally. The magnitude of this risk is great but the probability of its occurrence is relatively low.

Best Case: A pause in US Federal Reserve rate rises would be extremely beneficial, primarily due to downward pressure on the value of the dollar. The lifting of Chinese Covid restrictions could provide a strong tailwind to China and its trading partners. The new Brazilian president proves supportive of equity markets which flourish given the strong underlying fundamentals of the economy.

Data Sourced from FE Analytics, and FactSet

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CASH

Most Likely: Yields available for money market instruments should improve as the Bank of England continues its interest rate hikes. Nevertheless, the pace of interest rate increases is likely to remain behind inflation and so returns adjusted for inflation are likely to stay negative. These instruments will also suffer from negative capital returns as their prices move inversely to yields.

Worst Case: If more signs of recession appear, the Bank of England is likely to raise rates less aggressively, limiting the upside for money market funds. It will also mean that investors might revisit the case for UK government bonds as safe-haven assets, due to their sensitivity to interest rates. Cash instruments will therefore be a less compelling option for investors.

Best Case: The Bank of England may surprise and further hike rates if inflation proves to be stickier than expected, or simply to stay with the US Federal Reserve's tightening policy. If so, it is likely that the interest rate curve will steepen. This would improve the expected return from money market funds as managers can lock in higher rates at longer maturity dates, which may offset the loss from capital return. It would also mean cash will further help investors to protect from downside.



FIXED INCOME

Most Likely: The Bank of England and the US Federal Reserve reduce the size of their rate hikes as central banks become wary of over tightening monetary policy. Central banks also maintain their quantitative tightening programmes but the impact on market liquidity is limited and government bond yields remain stable. The UK enters a moderate recession and the US labour market shows early signs of weakness. Corporate bonds decline slightly due to the weakened growth outlook.

Worst Case: Inflation remains high and labour markets show little sign of loosening. Fiscal and monetary policy tightens, including more jumbo rate hikes from central banks, which dents government bonds. Restrictive policy pushes the UK and the US into recession as higher mortgage rates and declining real incomes reduce consumer spending. The premium paid by corporate borrowers jumps significantly.

Best Case: Commodity prices fall further, which helps to accelerate the decline in inflation. Rising unemployment means central bankers are able to ease rate hikes. Investors begin to price in significant rate cuts in 2023, which drives up government bonds. Removal of China's Covid restrictions boosts global growth and supports corporate bonds.



PROPERTY

Most Likely: The share prices of property companies declined in 2022 as the spectre of inflation and rising interest rates has spooked equity markets, but the performance of good property companies remains strong at the operating level. Going forward, favourable fundamentals and a rally in the broader equity market could help the shares of property companies, but another decline in equity markets would likely see the sector fall.

Worst Case: A weaker economic outlook negatively impacts equities, particularly those with a dependence on the economic cycle, such as the property sector. The most economically sensitive sub-sectors are particularly vulnerable – for example, retail, offices, and leisure. Rising bond yields continue to have a negative impact on company valuations.

Best Case: Property companies benefit from an equity market rally on expectations of a soft landing for the economy. Fundamentals remain strong in sub-sectors such as industrials, storage and healthcare, where supply and demand dynamics are favourable. Government bond yields stabilise or edge down, making shares in property companies more attractive on a relative basis.