APPENDIX 2

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Allenbridge

Fourth Quarter 2023 Investment Report

PREPARED FOR:

Derbyshire County Council Pension Fund: Pensions and Investment Committee Meeting

MARCH 2024

Investment Report for Derbyshire County Council Pension Fund

This report has been prepared by Anthony Fletcher "External Investment Advisor" of Derbyshire County Council Pension Fund (the Fund). At the request of the Pension and Investment Committee the purpose of the report is to fulfil the following aims: -

- Provide an overview of market returns by asset class over the last quarter and 12 months.
- An analysis of the Fund's performance by asset class versus the Fund specific benchmark for the last quarter and the last 12 months.
- An overview of the economic and market outlook by major region, including consideration of the potential impact on the Fund's asset classes.
- An overview of the outlook for each of the Funds asset classes for the next two years; and recommend asset class weightings for the next quarter together with supporting rationale.

The report is expected to lead to discussions with the in-house team on findings and recommendations as required. The advisor is expected to attend quarterly meetings of the Pensions and Investment Committee to present his views and actively advise committee members. To the extent this report contains advice it is intended as strategic advice to inform the investment strategy statement rather than investment advice.

Meeting date 6th March 2024
Date of paper 16th February 2024

1. Market Background (Fourth quarter 2023)

Headline Inflation fell more sharply than expected in Q4 and even the stickier components in the core inflation measure, that are still above the headline rate, also fell. As a result, the major central banks decided not to increase rates again over the quarter.

In December Jerome Powell the Chair of the US Fed's Open Markets committee (FOMC) appeared to change direction on his guidance on interest rates, suggesting that rates could start to fall in 2024. While other members of the FOMC have remained more hawkish pointing out the strength of the economy and tight labour markets, did not justify a cut anytime soon. The BoE and the ECB welcomed the fall in inflation but also made it clear that the primary goal of stable inflation had not yet been achieved, while noting that growth was much weaker in the UK and Europe than the US. Growth and inflation in China were also much weaker in the fourth quarter, even as the Chinese authorities put in place support measures aimed at easing the impact of the very weak property market.

The ongoing war in Ukraine and the new conflict in Gaza have the potential to renew inflationary pressures in Europe, especially as tensions in the middle east have increased attacks on shipping in the Red Sea causing traffic to re-route around Africa rather than using the Suez Canal.

Falling inflation and the apparent pivot from the US Fed enabled all equity and bond markets to rally strongly in the fourth quarter reversing the weakness seen in the third quarter. In local currency terms global equities returned more than 12%, with growth stocks outperforming, supported by the strong recorded earnings of a few IT companies and more generally the anticipated fall in interest rates.

Outside of the US other equity markets produced much smaller returns; Emerging equity due to the impact of the weakness in China; Japanese equity, which after a strong performance all year was held back by currency appreciation and in the UK a combination of lower oil and gas prices and the strength of the Pound.

As can be seen in table 1 below, long dated government bonds delivered the strongest returns over the quarter as markets optimistically priced in five 0.25% cuts in interest rates by the US Fed over 2024. Investment grade non-government bonds only slightly underperformed as spreads also narrowed over the quarter. High yield bonds also benefitted from the narrowing of spreads but their overall performance was again slightly lower due to their lower interest rate sensitivity.

Energy prices declined during the fourth quarter, with crude oil falling -19.2% from the highs of Q3 to finish the calendar year -10.3% down. Similarly, natural gas prices were down -14.2% and ended the year -43.8% lower, the largest annual percentage decline since 2006. The increased tensions in the Middle East and the weakness of the US dollar enabled the gold price to increase by more than 12%. The US dollar was also weak versus the UK pound, Euro and Japanese yen as currency traders also priced in lower US interest rates.

I would not be surprised to see more market volatility and lower equity and bond prices in the first half of 2024. In my opinion central banks are unlikely to be cutting rates until the second quarter and the number of cuts is likely to be lower than currently priced in by markets, especially if, as I expect, the pace of the fall in inflation slows.

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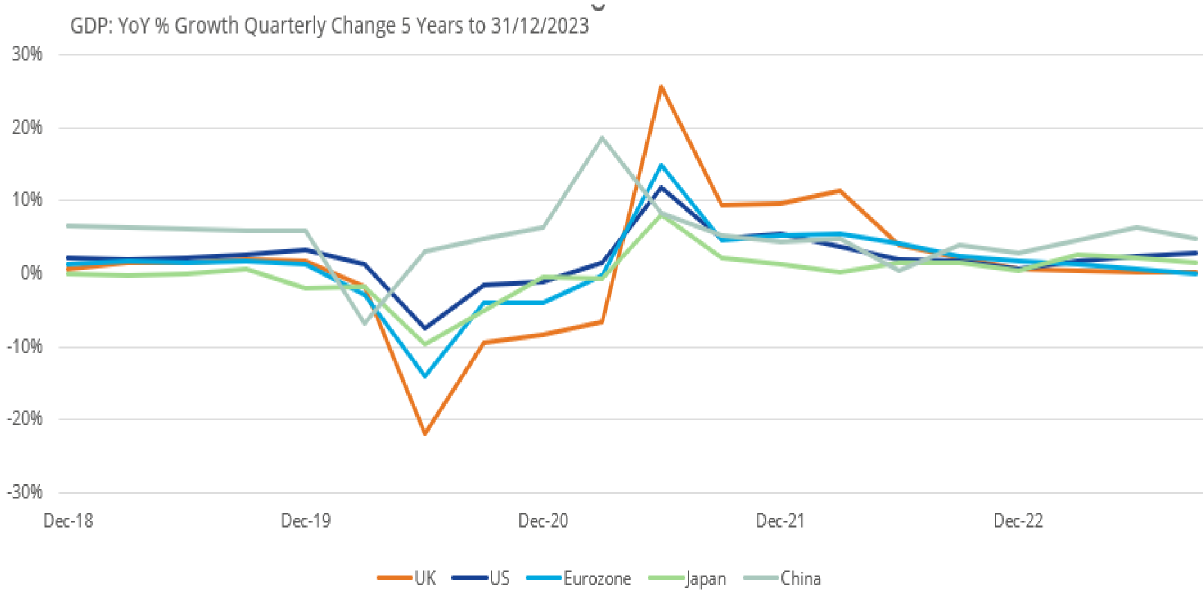
Chart 1: - Annualised rates of quarter on quarter GDP growth.



Source: - Bloomberg

Table 1, below shows the total investment return in pound Sterling for the major asset classes, using FTSE indices except where noted; for the month of January 2024 and the 3 and 12 months to the end of December 2023.

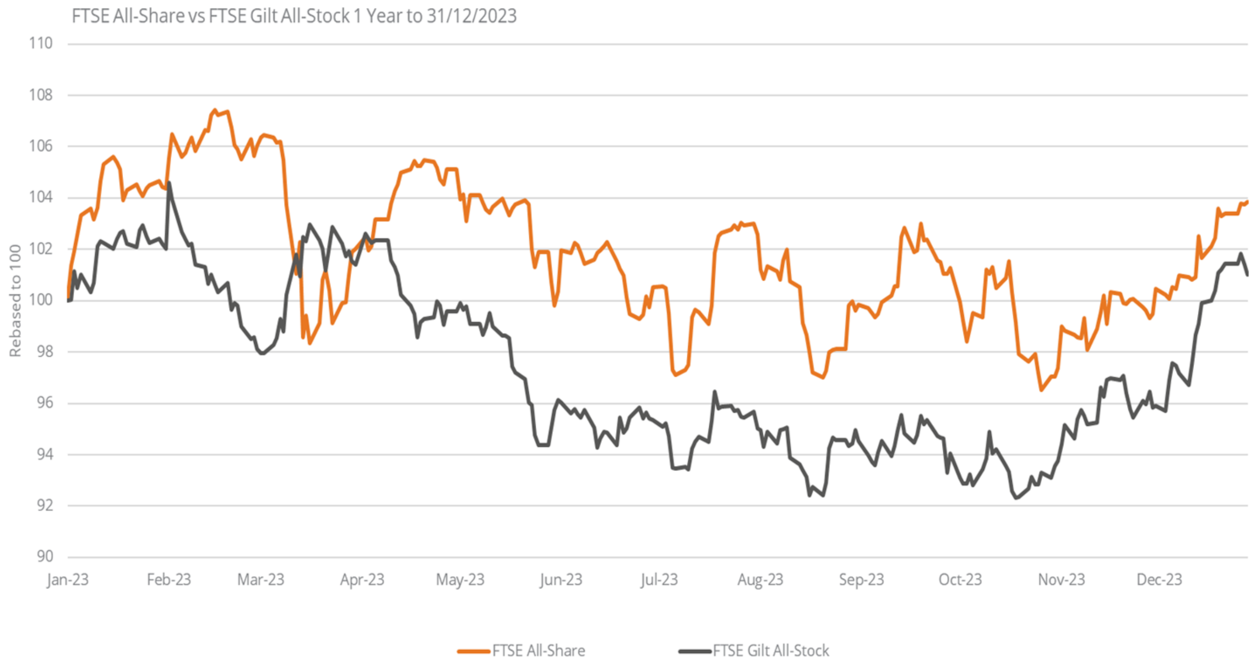
% TOTAL RETURN DIVIDENDS REINVESTED

MARKET RETURNS

		Period end 31st December 2023	
	January 2024	**3 months**	**12 months**
Global equity - FTSE – All World	+0.7	+6.3	+15.3
FTSE Regional indices			
UK All Share	-1.3	+3.2	+7.9
Japan	+4.3	+3.3	+13.3
Emerging	-3.4	+2.0	+2.7
UK Gilts - Conventional All Stocks	-2.4	+8.6	+3.6
UK Gilts - Index Linked All Stocks	-5.0	+9.5	+0.7
UK Corporate bonds*	-1.1	+8.4	+9.7
Overseas Government Bonds**	-0.3	+5.3	+5.1
UK Property quarterly^	-	-1.1	-2.8
Sterling 7 day SONIA	0.4	1.4	5.0

^ MSCI indices * ICE £ Corporate Bond, UC00; **ICE global government ex UK £ hedged, N0L1

Chart 2: - UK bond and equity market returns - 12 months to 31st December 2023



Source: - Bloomberg

Table 2: - Change in Bond Market yields over the quarter and 12 months.

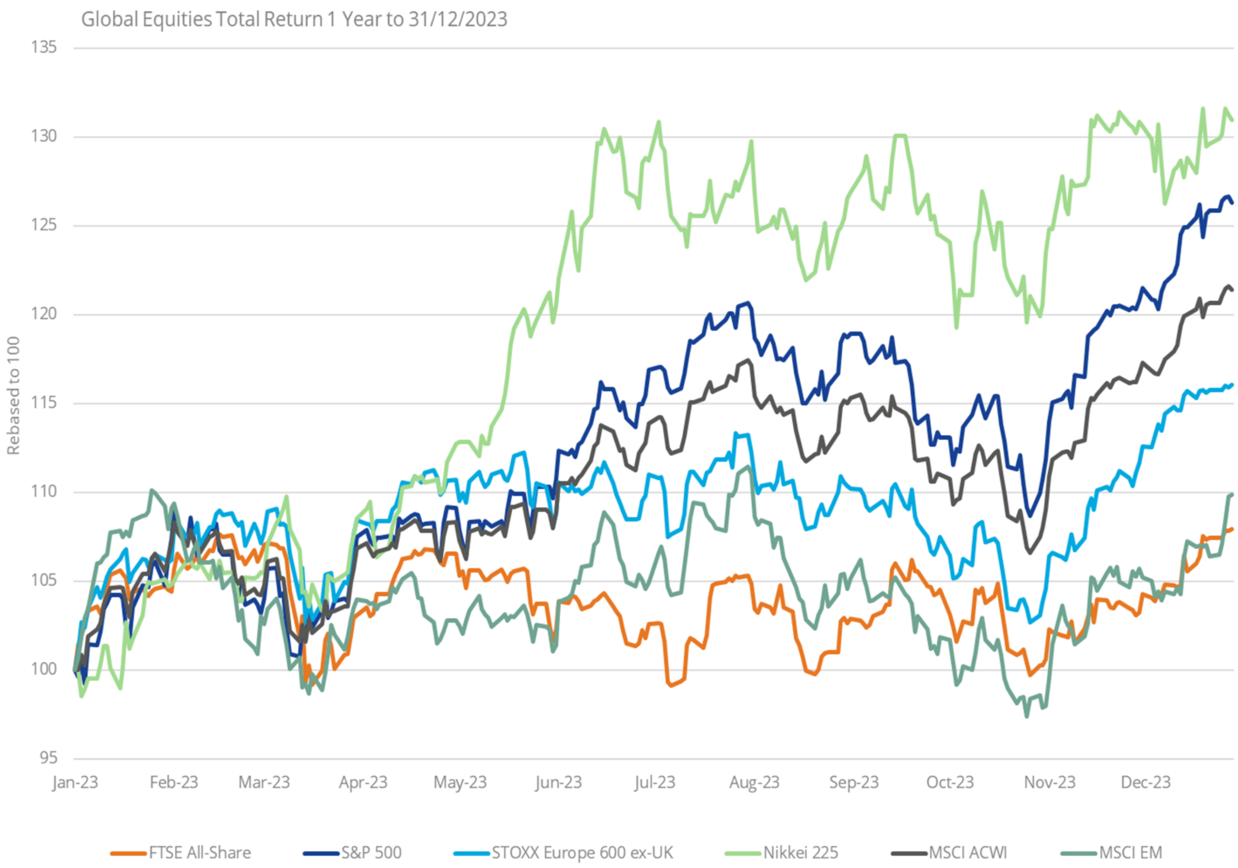
BOND MARKET % YIELD TO MATURITY	30th September 2023	31st December 2023	Quarterly Change %	31st December 2022	Current 16th February 2024
UK GOVERNMENT BONDS (GILTS)					
10 year	4.44	3.54	**-0.90**	3.67	**4.11**
30 year	4.90	4.14	**-0.76**	3.95	**4.65**
All Stocks ILG	+1.0	+0.5	**-0.50**	+0.24	**+1.0**
OVERSEAS 10 YEAR GOVERNMENT BONDS					
US Treasury	4.57	3.86	**-0.71**	3.83	**4.30**
Germany	2.84	2.03	**-0.81**	2.56	**2.40**
Japan	0.77	0.62	**-0.15**	0.42	**0.73**
NON-GOVERNMENT BOND INDICES					
Global corporates	5.58	4.66	**-0.92**	5.11	**4.93**
Global High yield	8.74	7.46	**-1.28**	8.90	**7.58**
Emerging markets	7.59	6.51	**-1.08**	7.07	**6.77**

Source: - Trading economics and ICE Indices G0LI, G0BC, HW00, EMGB, 16th February 2024.

Chart 3: - UK Bond index returns, 12 months to 31st December 2023

Source: - Bloomberg

Chart 4: - Global equity market returns in local currency, 12 months to 31st December 2023



Source: - Bloomberg

Recent developments (January and to 16th February 2024)

After the markets' party atmosphere in the last six weeks of 2023, that delivered strong positive returns, on the idea that the Fed was at the end of the tightening cycle and about to cut interest rates, the markets have had something of a hangover in the first 6 weeks of 2024, which in the year to date has led to negative returns. Performing especially poorly were the government bond markets which partied the most in December. Growth, employment and inflation data in the US have all been stronger than expected and while the Fed has maintained that it could cut rates three times in the next twelve months it's not the five cuts the markets had priced in and the first may not happen until the second quarter. The markets, at their peak of excitement, had expected the first cut no later than March 2024. Equity market returns have followed the same wave but with less amplitude. This is probably because earnings still seem to be better than expected and there has been an increase in corporate activity and a number of mergers and take overs being announced.

On the economic front the main disappointment has been inflation which at both the headline and core level have proved sticky and broadly unchanged in the last 3 months. While the Fed governor has talked about the possibility of rate cuts. Other members of the FOMC point to the strength of the economy and labour markets and have reminded the markets of the need for more data confirming that inflation is under control. The ECB and the Bank of England have made no such announcements on rate cuts, despite the weakness of GDP data. While they are predicting weaker growth in 2024, the BoE in particular have cited the strength of wages and the problems that causes for core inflation.

The other factor that is beginning to seep into the market psyche at the edges at least, is the Government Election cycle. The vast majority of the "democratic" world will be holding to varying degrees "free and fair elections" in 2024. With all candidates talking about tax cuts or at least no tax increases and many talking about increased fiscal spending, to make their countries great again, or aimed at supporting the transition to a lower carbon economy. Certain parts of the electorates are wondering about the negative impacts these policies could have for them and some bond market participants are beginning to question how it's all going to be paid for?

2. Investment Performance

The data presented in Table 3 below shows performance of the Derbyshire Pension Fund versus the Fund specific benchmark for the quarter and the year to 31st December 2023, as calculated by Northern Trust.

Based on the data below the Fund has slightly outperformed the strategic benchmark over the quarter and underperformed the benchmark over one year. Despite the tactical underweight position, the relative performance of Growth assets was responsible for a negative contribution to overall Fund performance. The combined total return of Protection and Income assets produced a positive contribution to overall performance.

Table 3: - Derbyshire Pension Fund and Benchmark returns

% TOTAL RETURN (NET) 31ST DECEMBER 2023	3 MONTHS		12 MONTHS	
	Derbyshire Pension Fund	**Benchmark**	**Derbyshire Pension Fund**	**Benchmark**
Total Growth Assets	**4.8**	**5.1**	**9.5**	**12.4**
UK Equity	3.6	3.2	7.8	7.9
Japan	3.6	3.3	9.8	13.3
Emerging markets	1.9	2.0	0.4	2.7
Global Sustainable Equity	6.6	6.4	11.9	15.2
Global Private Equity	2.8	6.7	10.5	16.2
Total Protection Assets	**8.1**	**8.2**	**5.3**	**4.5**
UK & Overseas Government	8.1	8.1	3.5	3.7
UK & Overseas Inflation Linked	7.8	8.7	1.4	0.9
Global Corporate bonds	8.3	7.8	10.1	8.9
Total Income Assets	**2.8**	**1.2**	**5.3**	**4.3**
Multi-asset Credit	4.0	3.6	11.5	10.5
Infrastructure	3.8	1.8	5.3	6.8
Property (all sectors)	+0.2	-1.1	-0.4	-2.2
Internal Cash	0.0	1.3	1.3	4.7
Total Fund	**4.7**	**4.6**	**7.5**	**8.9**

Total fund value on 31st December 2023 £6,225 million

Growth assets – Equity performance

The aggregate performance of growth assets in the fourth quarter and the year was lower than the strategic benchmark. Over three months UK, Japan and Global sustainable equity slightly outperformed their respective benchmarks while other allocations underperformed.

Over the year all the Fund's equity managers underperformed their benchmarks. The unusually large underperformance of Global private equity is most likely explained by the three month lag in the valuations when compared the strong benchmark returns of public equity seen in the fourth quarter.

Protection assets - Fixed Income Performance

The strong rally in bond prices seen in the fourth quarter delivered a large positive absolute return but despite the Fund's defensive positioning it performed broadly in-line. Over the year, this defensive positioning enabled Protection assets to outperform the benchmark.

Income assets – Property, Infrastructure and MAC

Over the quarter, the combined portfolio of income assets delivered a positive return and outperformed the benchmark. Over the year Infrastructure returns were lower than the benchmark but as noted above for Private equity this could be the lagged valuation of some of the assets in this allocation. Despite the underperformance of Infrastructure and the negative return of Property, the aggregate return of the Income asset component was positive and ahead of benchmark.

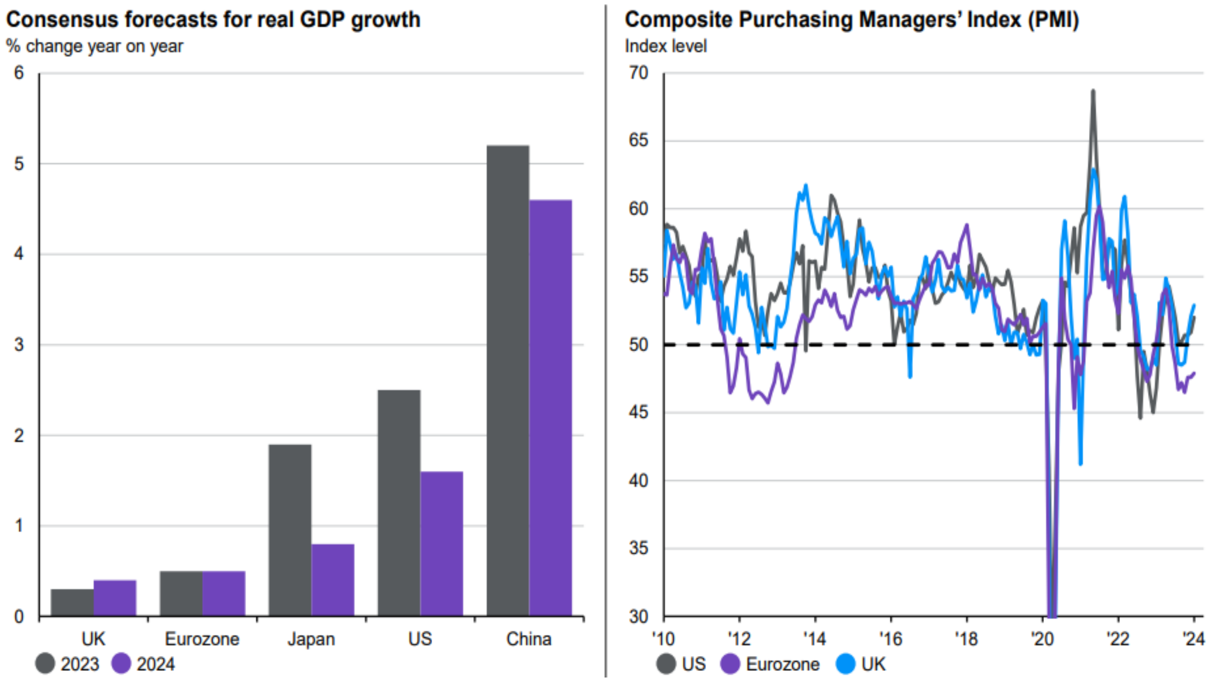
3. Economic and Market outlook

Economic outlook

The most recent set of consensus GDP forecasts for 2023 and 2024 have been revised down. We almost have the full year advance data for 2023, so these estimates just serve as an idea of last year's growth. While the result if not especially great in the UK and Europe it is not the forecast recession expected in January 2023 and growth in the US was much better than expected. I believe the forecasts for 2024 suffer from the same pessimism and may be revised higher as we go through the year. As noted before there are admittedly weakening tail winds compared to last year but they still exist: Fiscal spending in all the developed economies is still increasing, higher interest rates mean savers have more money and while employment data may be softening higher earnings are recurring, unless one becomes unemployed. As headline inflation continues to fall, cost pressures for businesses will stabilise and higher wages and interest income, become real increases in spending power. As suggested in my last report the composite PMI has turned higher with both the component manufacturing and services PMIs turning higher, led by the US.

The resilience of growth especially in the US does make it more difficult for the Fed the cut interest rates even though they have indicated they would like to so, as headline inflation, at least, appears to be under control. I no longer believe rates will rise but I do not believe they need to be cut to help growth in the US. It could be argued that based on growth alone rates could be cut in the UK and Europe, but here inflation is still the problem and in all three regions labour markets remain tight, which could keep the pressure on core inflation. As a result, I believe interest rates will remain higher for longer than the markets expect and the pace of cuts when they come will be slower. As noted last quarter Chinese economic growth remains weak and the economy is experiencing deflation, which it is exporting to the rest of the world through lower goods prices.

Chart 5: - Consensus GDP forecasts and PMI's (leading indicators of growth)



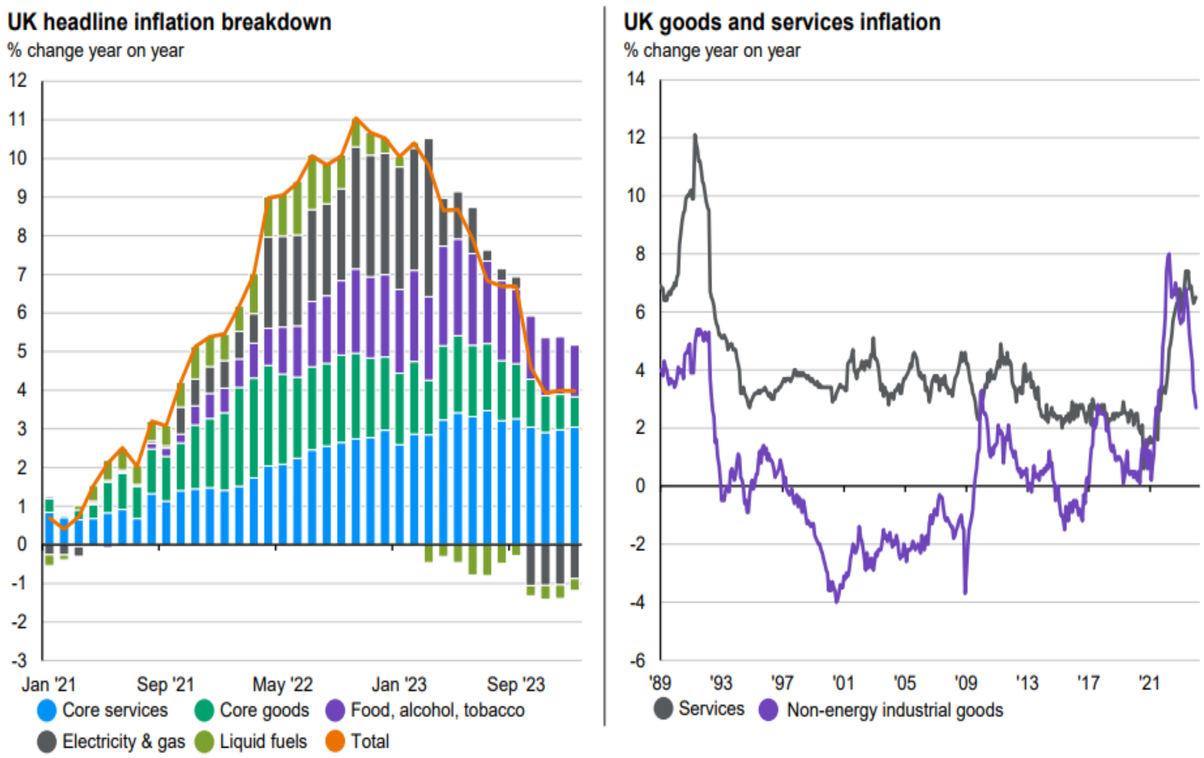
Source: - JPMorgan Asset management February 2024

Inflation

Inflation remains the key economic variable and the news on headline rates at least remains good even though in recent months headline CPI has gone sideways in the US, UK and Europe after significant falls earlier in the year. Core inflation on the other hand remains sticky in all regions and broadly for the same reasons, tight labour markets and higher wages, as the pale blue bars in the left hand chart below shows for the UK.

The left hand graph on Chart 6 shows in the orange line, that UK headline inflation has flatlined for the last three months, but energy prices and the electricity and gas price cap are making a year over year negative contribution. The right hand graph shows core goods and services, while goods prices continue to fall, services inflation remains stubbornly high.

Chart 6: - UK headline and core inflation and the components of headline inflation.

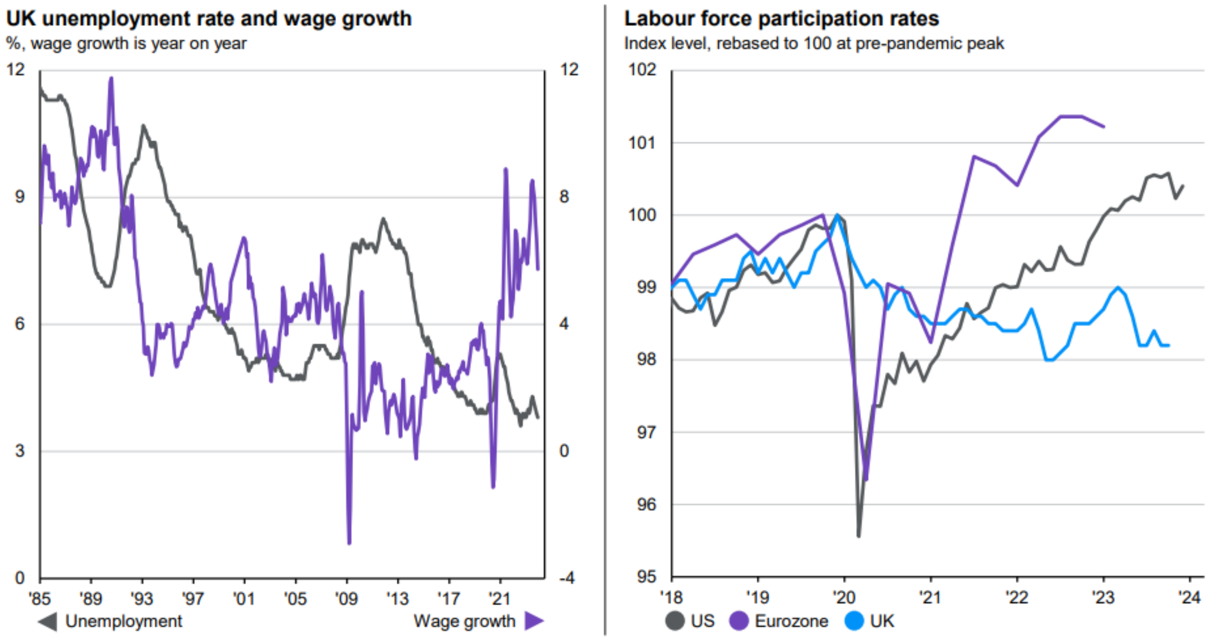


Source: - JPMorgan Asset management February 2024

As can be seen in the purple line of the left hand graph on Chart 7 below, wage growth in the UK has softened slightly from over 8% to around 6%, but unemployment the black line remains at an almost 30 year low. This labour market tightness is underpinning the stubbornly high rate of core inflation, which as can be seen in chart 6 is mainly coming from services. However as noted elsewhere with wage growth above inflation employees are beginning to see increases in real income, and this should support increased consumption and maybe stronger overall growth in the economy. The right hand graph on Chart 7 shows Labour participation rates and it suggests that even fewer people in the working age population, ie those aged between 16 and 64 in the US and the UK are active in the labour market. If these "inactive" people were to return to the workforce it could further ease the pressure on inflation.

I believe the easy part of getting inflation down has come to an end, as the first round effects from higher energy prices drop out of the year over year figures. It is possible to see inflation return to levels close to the BoE's target range but this is going to be difficult to achieve with the labour market tightness shown in these charts.

Chart 7: - Tight labour markets and strong wages growth are keeping pressure on Core CPI.



Source: - JPMAM February 2024

Central Banks

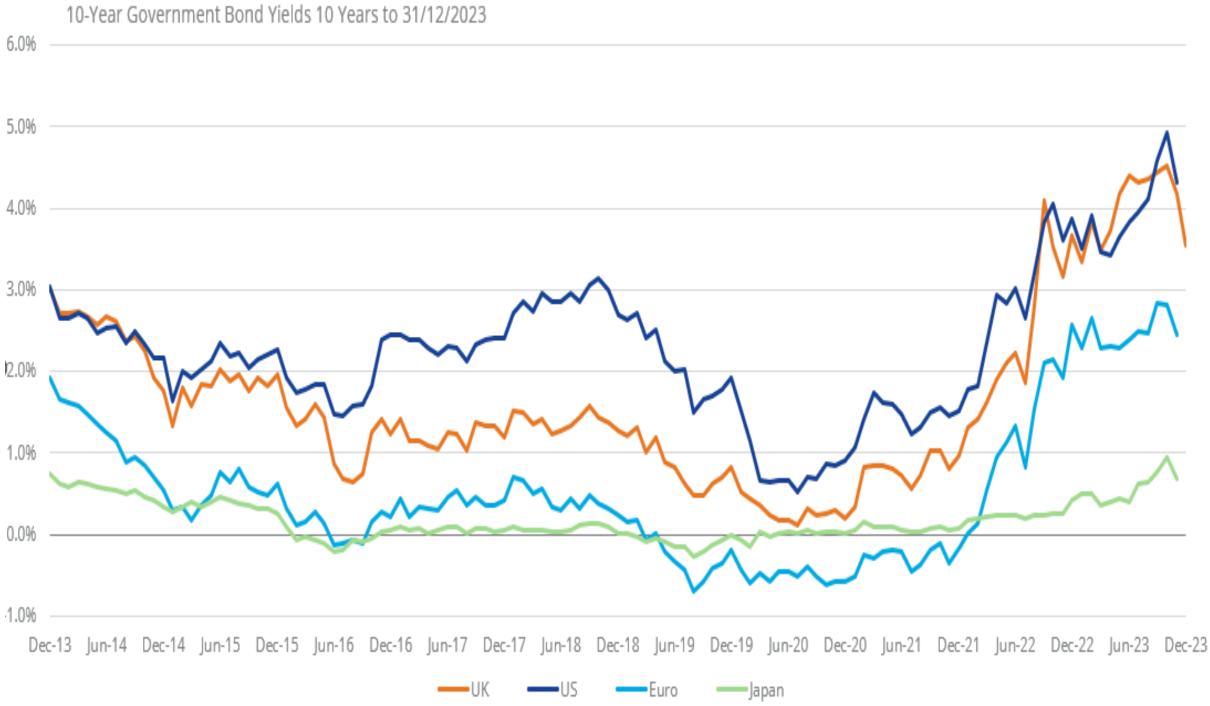
The conclusion I arrive at from the growth and inflation outlook above is that central banks do not urgently need to cut interest rates. I believe we have come to the end of the interest rate tightening cycle but the central banks continue to sell down their stock of bonds accumulated during their quantitative easing programmes and as mentioned before I believe the Bank of Japan is about to start increasing their overnight rate.

The Chair of the US Fed said that they could cut rates three times in the next twelve months if they become more confident that inflation is under control but it now looks as though that may not happen before May 2024 and then they have the problem of the Presidential election season which will start in earnest in the summer. It would be normal based on past experience for the Fed to leave interest rates unchanged during the election campaign to avoid political criticism. While the weakness of growth in Europe and the UK supports the consideration of a cut in rates, core inflation does not and I believe it is unlikely that the ECB or the BoE would cut before the US Fed.

Faced with a slowing economy and weakness in the property market, the People's Bank of China (PBoC) cut their 5-year loan prime rate, used to set mortgage rates by 25bps to a record low of 3.95% at the February fixing but held the one year rate at 3.45%. Earlier in the month, the central bank injected CNY 1 trillion (US$140billion) of liquidity into the banking system by cutting commercial bank reserve requirements by 50bps, if this is passed on fully it will have a significant impact, reducing interest rates and promoting loans to agricultural and small firms.

Government bonds

Chart 8: - Government bond yields, last 10 years.



Source: - Bloomberg

As Chart 8 above shows 10 year government bond yields for the major developed markets all fell during the fourth quarter from their highs in October. The decline was triggered by the decision of the central banks not to raise rates at their meetings in October, November and December. Bond markets got even more excited in December when US Fed Chair, Jerome Powell suggested there could be three rate cuts in 2024. As a result, government bonds produced very strong positive returns. In 2024 bond markets have been somewhat weaker as other Fed members have highlighted that there is still insufficient data to confirm Inflation is under control and economic data has pointed to higher growth and slightly higher inflation, this had led to negative returns.

I had not anticipated the magnitude of the volatility in government bonds, but it would appear I may have been correct about their sensitivity to data and central bank announcements and the possibility of a sideways range. The possibility of a bearish flattening where long dated yields fall less also appears to be happening via a steepening of yield curves beyond 10 years. Stable core inflation remains the key to lower interest rates and sustainably lower bond yields and that is still about 6 months away. If the consensus forecast for growth in 2024 turns out to be wrong and economies fall into recession, this could pull forward rate cuts and deliver positive returns from government bonds. But I would attach a low probability to this outcome and even if rate cuts were brought forward, they would probably be quite small.

Government bond yields have become more interesting after years of being highly over valued and may be worthy of consideration in the context of the liabilities that the Derbyshire Pension Fund needs to meet. I accept that relative to other opportunities, government bonds may still be at the low end of expected returns, but it should also be remembered that unlike equity the income is almost guaranteed.

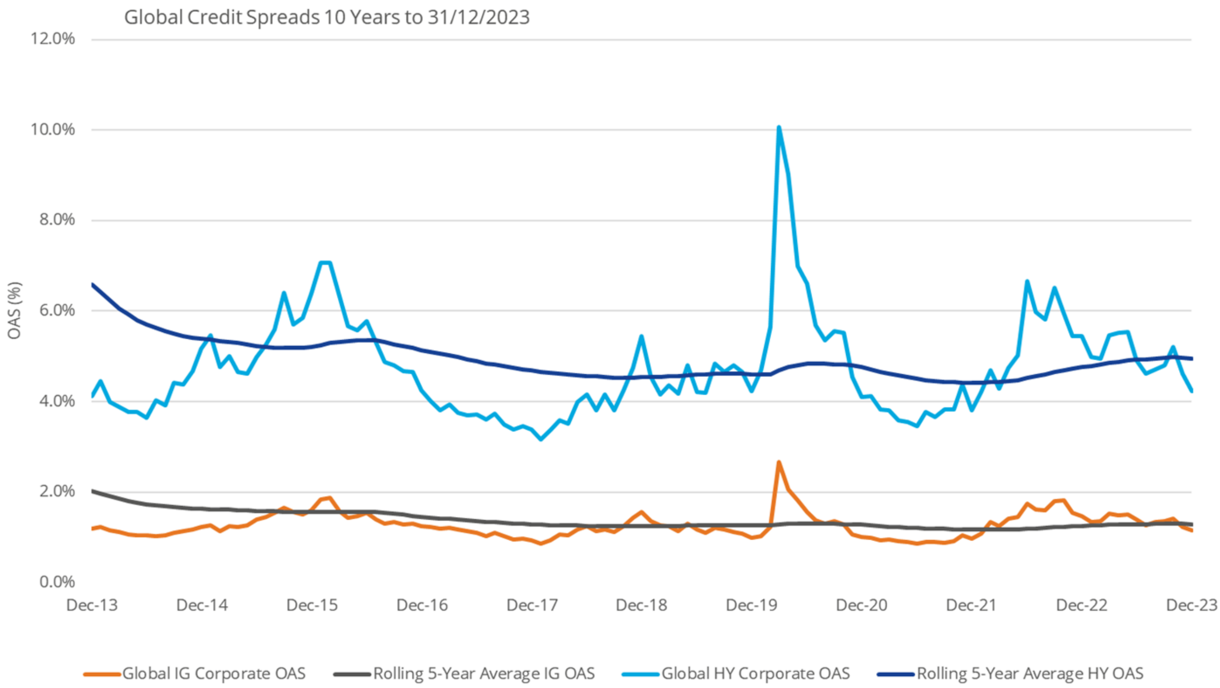
Non-government bonds

Chart 9 below, shows the excess yield spread for both investment grade non-government and high yield bonds to the end of the quarter. As can be seen from the chart spreads narrowed over the quarter and even as government yields have risen year to date, spreads have fallen further, outperforming duration equivalent government bonds in both directions.

This has in the short term at least made non-government bond look more expensive on a relative value basis, indeed as the chart below shows both investment grade and high yield bond spreads are below the five year moving average. However, over the medium term they could still be attractive compared to a few years ago as they have lower duration and a higher total yield than government bonds.

I still expect Multi-asset Credit funds, with their mix of low duration bonds and floating rate loans, to provide good income based returns, provided our managers continue to avoid defaults.

Chart 9: - Credit spreads, extra yield over government bonds, last 10 years.



Source: - Bloomberg

Equities

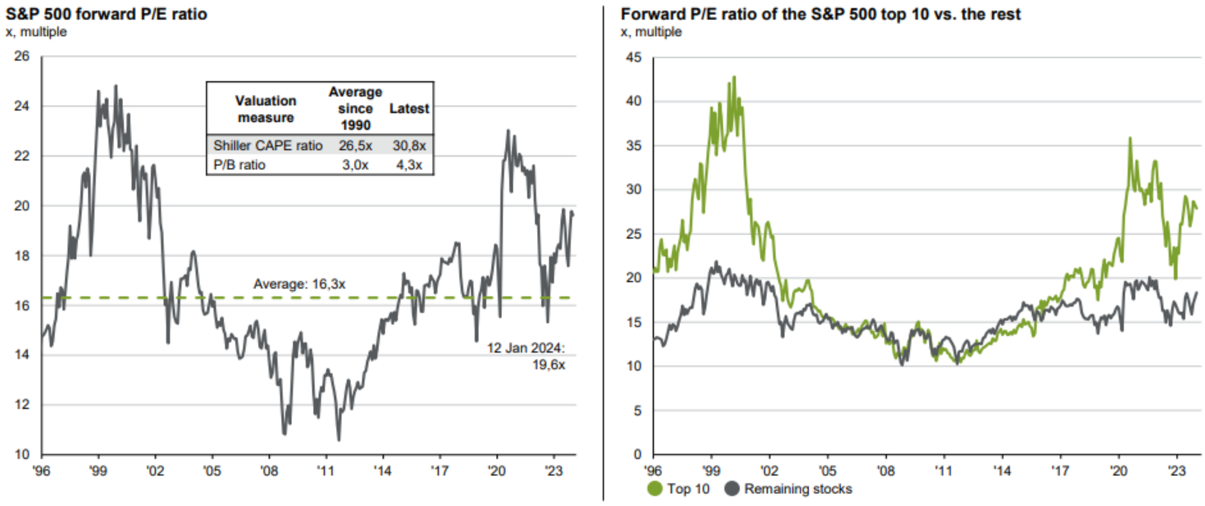
Equity markets rallied strongly at the close of the year with Japanese, US and Global indices recording new highs. Like the bond markets, equity markets have become more sensitive to data releases and central bank announcements. Unlike the bond markets these indices have motored on to even higher levels in 2024, as the profits of Tech and in particular AI linked companies like Nvidia exceeded expectations. In Japan the Nikkei index has achieved a new All Time High exceeding the high seen in 1989.

Outside of these indices, markets like the UK, Europe and China continue to struggle. The UK and European indices are now some 35% cheaper than the US, but as explored in section 4 of this report I believe this may be more related to the sector weights of the indices rather than any macro-economic factors. I believe the weakness of China is related to the macro-economic impact of the weak property market.

In my last report I wrote that I believed equity markets could struggle to deliver the strong returns we have become used to, because of the greater competition for capital and because bonds and cash offer a lower risk source of returns. This may remain true for the broader equity markets but maybe not for the global IT and AI linked companies and those indices that are heavily weighted to these sectors as they continue to be able to attract capital and deliver upside earnings surprises.

In the next few charts, I am going to explore how valuations in the US indices maybe too expensive as they have the highest weight to IT / AI companies. Chart 10, the left-hand graph shows how expensive the whole S&P Index has become due the price of the top 10, mainly IT companies but at least at the moment the top 10 are delivering positive earnings surprises. The right hand graph separates out the top 10 from the "rest" and shows the "rest" are only fair value when compared to the whole index average over the last 25 years as shown on the left hand graph.

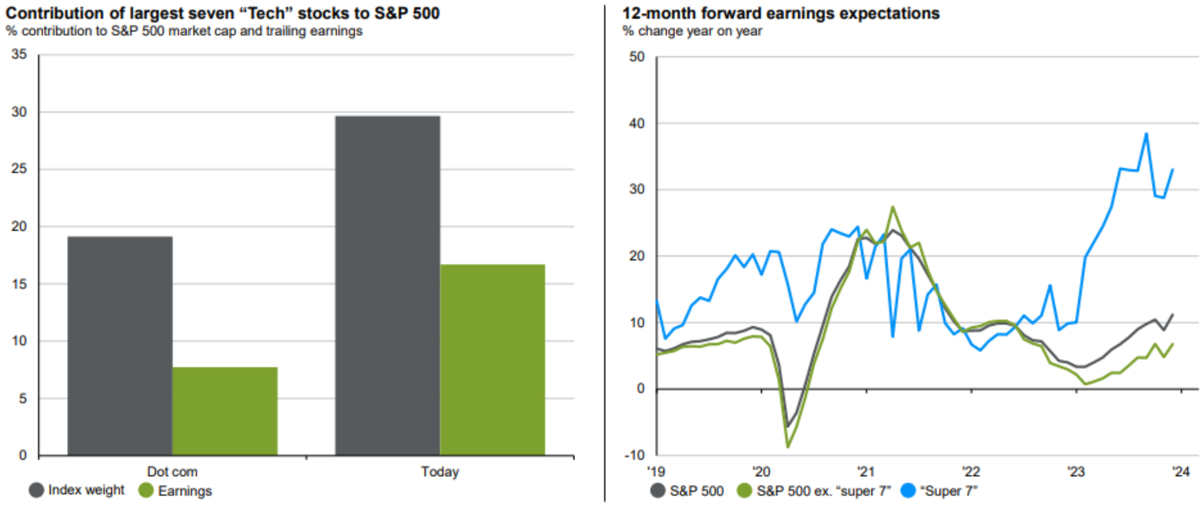
Chart 10: - S&P Whole index P/E ratio on the left. Top 10 constituents, compared to the rest of the index on the right.



Source: - JPMAM February 2024

On Chart 11 below the left hand graph shows the weight of the largest seven tech stocks in the S&P 500 and their past earnings contribution to the index in the Tech bubble of 2000 compared to the largest seven Tech stocks today. The right hand graph shows the earnings expectations for the next twelve months of the "super 7" Tech stocks compared to the rest of the S&P 500 index. While the left hand chart gives some comfort that trailing earnings seem to better justify the market capitalisation weight in the index. If markets are "efficient" the earnings forecasts in the right hand graph are already in the price not just of the "super 7" but of the whole index, which leaves little scope for earnings disappointment, unless these "super 7" companies continue to deliver better than expected earnings.

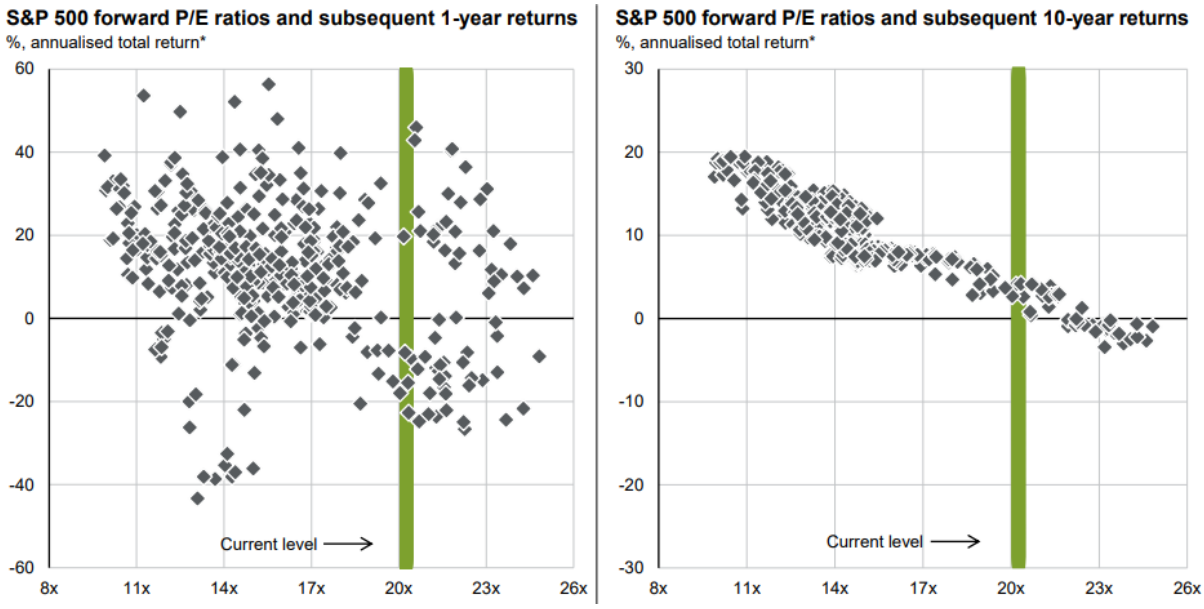
Chart 11: - S&P 500 past earnings and sector index weight on the left. Expected earnings of the whole index and the "super 7" Tech constituents, on the right.



Source: - JPMAM 12th January 2024

My final chart 12, shows the past performance of the S&P 500 over 1 year and 10 years compared to the aggregate P/E ratio. The left hand graph of 1 year forward P/E shows that there is almost no relationship in the 1 year returns, as they range between +40% and -25%, but more of returns at 20X level of P/E are negative. The right hand graph of 10 year returns cluster below +5% per annum. This is not a bad return but it is a similar return to what is currently available from lower risk fixed income assets with much lower volatility.

Chart 12: - S&P 500 past earnings and sector index weight on the left. Expected earnings of the whole index and the top 7 Tech constituents, on the right.



Source: - JPMAM February 2024

Based on the above analysis in the short to medium term I believe US and global equity markets are overvalued and vulnerable to disappointment from a macro-economic and company specific point of view, therefore I am comfortable for the Fund to be underweight growth assets.

GDP

Table 4 shows the consensus forecasts for GDP growth in calendar 2023 and 2024 in January and my expectations in November 2023 and January 2024.

Table 4: - GDP forecasts - Consensus versus Advisor expectations.

% CHANGE YOY								
	2023				2024			
	NOVEMBER		JANUARY 2024		NOVEMBER		JANUARY 2024	
	Consensus	AF	Consensus	AF	Consensus	AF	Consensus	AF
US	2.2	**2.2**	2.4	**2.5**	0.9	**1.0**	1.4	**1.5**
UK	0.4	**0.5**	0.4	**0.1**	0.3	**0.5**	0.2	**0.5**
Japan	1.9	**2.0**	1.9	**2.0**	0.9	**1.0**	0.8	**1.0**
EU	0.5	**0.5**	0.6	**0.5**	1.0	**1.0**	0.9	**1.0**
China	5.0	**4.5**	5.2	**5.2**	4.4	**4.0**	4.6	**4.0**
SE Asia	4.0	**4.3**	4.0	**4.0**	4.5	**4.5**	4.5	**4.5**

Source: - Consensus Economics January 2024

The consensus forecasts for GDP growth in 2023 had to play catch up with the better than expected actual data throughout the year. The estimates of 2023 growth shown in the table for January 2024 are largely what has already been reported in the preliminary data. However, it should not be forgotten that these figures will continue to be revised by government statisticians as they get more physical data. In the case of the UK, the ONS will take another 2 years before it publishes its official 2023 GDP data. The main drivers of growth remain broadly the same, consumer spending especially on services, supported by higher earnings and falling headline inflation. The most recent earnings data shows that wages are increasing in real terms. Higher costs appear to be holding back investment and expenditure in manufacturing and construction. Consensus estimates for growth in 2024 have come in lower than in 2023, but like last year I believe these could once again turn out to be too low. I accept that they could be lower than 2023 but I have decided to stick with my above consensus estimates for GDP growth for 2024, for the reasons mentioned above and because with inflation much more under control central banks can respond with lower interest rates if needed.

In the fourth quarter of 2023 the Chinese economy grew at an annual rate of 5.2%, slightly faster than the 4.9% growth rate achieved in the year to the end of the third quarter. Quarterly data showed that industrial production rose the most in almost two years, but retail sales fell and the growth rate remains low, the official unemployment rate edged up to a four-month high. The annual growth rate of 5.2%, was slightly ahead of the official 5% target and a marked increase from the lacklustre 3.0% growth rate achieved in 2022. The improvement was largely achieved through increases in government support measures aimed at offsetting the impact of the domestic property crisis and persistently weak consumption. Excluding the pandemic years, 2023's 5.2% annual growth rate was the lowest since 1990.

The advance estimate showed that the US economy grew at an annualised rate of 3.3% in the fourth quarter, lower than the 4.9% annualised rate achieved in the third quarter, but stronger than the expected 2%. While consumer and government goods spending slowed, consumption of services increased at a faster rate, led by food services, accommodation and health care. The balance of trade also improved with exports increasing and imports falling. Non-residential investment increased, mainly due to large rebound in equipment spending and a rise in intellectual property products. Construction remains weak with investment in structures falling to 3.2% from 11.2% and residential investment also growing at a slower pace. Over 2023, the US economy grew 2.5%, in line with the Fed's estimates of 2.6%, compared to 1.9% in 2022 and well ahead of the consensus estimates at the beginning of the year.

As widely expected for some time the UK finally fell into a technical recession in the fourth quarter of 2024. Preliminary estimates of GDP in the fourth quarter suggested that the economy contracted by -0.3%, following a -0.1% decline in the third quarter. The decline in economic activity was broad based with services, industrial production, construction, government consumption and exports, all showing negative growth. Imports and household spending were down less compared to the previous quarter. The only component that made a positive contribution to growth was gross capital formation, mainly through buildings and structures. After bouncing around zero all year, the preliminary estimate of growth for 2023 as a whole is currently +0.1%, better than the -0.5% forecast in January 2023.

Preliminary estimates showed that the Euro Area achieved 0% growth in the last three months of 2023, after a contraction of -0.1% in the third quarter. Zero aggregate growth means the region narrowly avoided a technical recession, ie 2 consecutive quarters of negative growth. The 2 largest economies; Germany -0.3% and France at Zero, were the main detractors with better than expected growth in Spain +0.6% and Italy +0.2% and positive contributions coming from other smaller economies including Portugal +0.8%, Belgium +0.4%, Latvia +0.4% and Austria +0.2%. The Full year preliminary estimate for Euro-Area growth in 2023 was +0.5%, well below last years growth rate of +3.4%.

The Japanese economy shrunk by -0.7% in the third quarter, and first and second quarter 2023 growth rates were also revised from +0.8% to +1.2% and from +1.2% to +0.9% respectively. There were declines in private consumption, capital expenditures and public investment. Net trade was also a drag on the GDP, as exports increased less than imports. The only area that saw an increase was government spending, which increased by +0.3%, compared to -0.1% in the second quarter. The latest data has trimmed the annual growth rate from +1.6% in June, to +1.5% in the twelve months to the end of September 2023.

MJ HUDSON Allenbridge

Consumer Price Inflation

Table 5 shows the consensus forecasts for Consumer Price Inflation in calendar 2023 and 2024 in January and my expectations in November 2023 and January 2024.

Table 5: - Consumer Price Inflation forecasts - Consensus versus Advisor expectations

% CHANGE YOY								
	2023				**2024**			
	NOVEMBER		JANUARY 2024		NOVEMBER		JANUARY 2024	
	Consensus	**AF**	Consensus	**AF**	Consensus	**AF**	Consensus	**AF**
US	4.1	**3.5**	4.1	**3.5**	2.6	**3.0**	2.6	**3.0**
UK	7.4	**7.0**	7.3	**6.9**	3.1	**4.0**	2.7	**3.5**
Japan	3.2	**2.5**	3.2	**2.5**	2.2	**2.5**	2.2	**2.5**
EU	6.1	**6.0**	7.3	**6.0**	3.0	**3.0**	2.7	**3.0**
China	0.6	**0.6**	0.4	**0.6**	1.7	**1.5**	1.2	**1.5**
SE Asia	3.6	**3.6**	3.5	**3.6**	2.9	**2.5**	2.8	**2.5**

Source: - Consensus Economics January 2024

The consensus forecasts for inflation in January 2024 have not changed materially in all developed economies for both 2023 and 2024. I expect inflation in 2024 to be lower than it has been in 2023, but I am happy to stick with my above consensus expectations, because as mentioned above, growth although anaemic may be stronger than expected. Tight labour markets, rising real incomes and the willingness of consumers to spend especially on services may also be another factor that could keep core inflation higher for longer than expected. As noted before, falling headline inflation now means that cash has a real cost and is higher than we have experienced over the last 15 years and that could continue to have an impact on core inflation over the next year or so.

China's annual headline inflation rate fell to -0.8% in January 2024, the lowest level in more than 14 years. Transportation costs fell by -2.4% and the costs of food and most services increased at slower rate. The core rate of inflation was also lower at +0.4%.

The headline inflation rate in the US increased to 3.4% in December from a five-month low of 3.1% in November. The main driver was a smaller fall in energy prices compared to the fall in November. Headline inflation was lower than in September and about half of what it was at the beginning of 2023. Other components of inflation increased at a slower pace including food, shelter, medical services and new and used car prices. Core inflation which excludes more volatile components like energy and food prices increased by 3.9%, continuing its falling trend.

The UK's inflation rate was unchanged at 4.0% in January 2024, slightly above the two-year low of 3.9% recorded in November. As in most countries and mainly due to base effects the month on month annual rate of inflation has fallen significantly since the beginning of 2023. However, the monthly average for 2023 was 6.9% and even at 4% it remains double the Bank of England's mid-range target of 2.0%. There was a slowdown in the pace of price declines for housing and utilities, mainly due to falling gas and electricity, and transport prices. Inflation also slowed sharply for furniture and household goods and slightly for food and drink. Miscellaneous goods and services were the only area to see greater increases in price. The annual core inflation rate, which excludes volatile items such as energy and food, held steady at 5.1%, also for the 3rd month in a row.

Preliminary estimates show that the annual headline inflation rate in the Euro Area declined to 2.8% January 2024. Helped by smaller increases in energy and food prices. The core measure that excludes food and energy also fell to 3.3%, while aggregate services prices remained steady at 4%, non-energy industrial goods prices only increased by 2%. These increases in Euro-area inflation are the lowest since March 2022.

The annual headline inflation rate in Japan fell to 2.6% in December down from 3.0% in September, the lowest rate since July 2022. The continued decline was the result of falling energy prices and smaller increases in food and most services prices. Prices for transport, clothing, furniture and recreation increased slightly, despite this the core rate of inflation also continues to fall, at 2.3% core inflation is increasing at the lowest rate in 18 months.

4. The outlook for the securities markets

Bond Markets

In table 6, below I have set out my expectations for 3 month SONIA interest rates and benchmark 10 year government bond yields, over the next 6 and 12 months. They are not meant to be accurate point forecasts, more an indication of the possible direction of yields from February 2024.

Table 6: - Interest rate and Bond yield forecasts

%	CURRENT	JUNE 2024	DECEMBER 2024
UNITED STATES			
3month SONIA	5.58	5.25	5.00
10 year bond yield	4.30	4.30	4.25
UNITED KINGDOM			
3month SONIA	5.32	5.25	5.00
10 year bond yield	4.11	4.10	4.00
JAPAN			
3month SONIA	0.10	0.25	0.50
10 year bond yield	0.73	1.00	1.25
GERMANY			
3month SONIA	3.90	4.00	3.75
10 year bond yield	2.40	2.40	2.30

Source: - Trading Economics; 16th February 2024

It is looking increasingly likely that central banks may begin cutting interest rates in the Summer of 2024. The US Fed has given clear guidance that they could reduce the Fed Funds rate 3 times over the next 12 to 18 months as US inflation appears to be under control. The BoE and the ECB have given no such guidance despite the low level of economic growth. In the fourth quarter the bond markets chose to price in this news with a huge rally in prices / fall in yields, leading to a very strong positive performance from long duration bonds in particular. In 2024 year to date bond prices have fallen on better than expected growth and employment reports and slightly less good news on inflation. The market which had priced in as many as 5 rate cuts starting as early as March 2024 has become less optimistic on the number of cuts and how early they will start. Over the medium to long term bond markets should also be taking into consideration the US and UK election cycles and the impact this may have on borrowing and budget deficits. As all the political discussion in both countries is about how much they want to cut taxes without reducing spending.

From the current level I believe it is quite difficult for inflation to fall much lower than what is already in the consensus forecasts on table 5 above. Unless there is a full blown recession, energy prices are unlikely to fall much further, and full employment and higher costs is keeping pressure on core inflation. This leads me to the conclusion that government bond markets are overvalued in the short term and poor returns could be expected. I am also concerned about the high levels of government debt and the cost of financing it, as this should lead to higher long term rates and further steepening of yield curves.

As mentioned above the yield of longer dated Gilts has been volatile and currently yields are around 0.5% lower than they were at the time of my last report. However real yields are more or less unchanged and yield curves are much steeper than 12 months ago. Because I believe these two trends remain in place, I would not suggest increasing exposure to protection assets at this time.

It would appear that all the recent volatility was mainly expressed in government bond yields with non-government bonds outperforming government bonds, leaving spreads narrower than they were at the time of my last report. As noted before non-government bonds have lower interest rate sensitivity, but as chart 9 above shows investment grade and especially high yield spreads have narrowed significantly below the 5 year average. This makes them less attractive in the short term, but the "all in yield" for corporates remains attractive and as table 7 below suggests, high yield bonds remain attractive in a rising yield environment provided the default rate doesn't increase significantly.

As usual in table 7 below I have updated the data and recalculated my estimates of the total return impact of rising yields for government and non-government bond indices based on their yield and interest rate sensitivity (Duration) over 3 and 12 months.

Table 7: - Total returns from representative bond indices

INDEX	YIELD TO MATURITY %	DURATION YEARS	YIELD INCREASE %	% TOTAL RETURN, HOLDING PERIOD	
				3 MONTHS	12 MONTHS
All Stock Gilts	4.3	9.0	0.5	-3.4	-0.2
All Stocks Linkers	1.0	14.1	0.5	-6.8	-6.0
Global IG Corporate	4.9	5.9	0.5	-1.7	+2.0
Global High Yield	7.6	3.3	0.5	+0.2	+5.9

Source: - ICE Indices 16th February 2024

Bond Market (Protection Assets) Recommendations

I suggest that the Fund sticks with its current allocation to Protection assets and remains neutral investment grade corporate bonds. The extra yield spread available from corporate bonds has narrowed significantly since my last report, but all in yields are higher than they have been for some years.

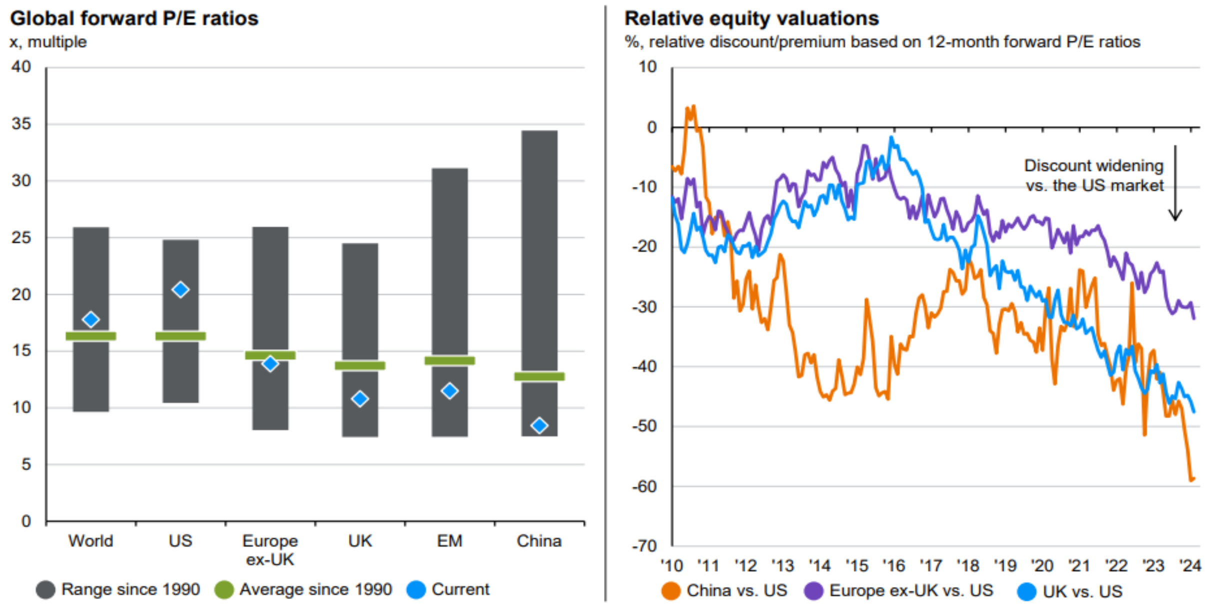
After the rally and more recent volatility in government yields, I believe the outlook for returns from government bonds remains mixed, in the short term I would not be surprised to see yields higher or lower on the back of economic news. As a result, it may be worth keeping the duration of the Fund's allocation to fixed interest Gilts benchmark neutral. However, as I have mentioned before Gilts and Index Linked Gilts remain over-valued and I remain pessimistic about the longer-term fall in demand and potential increased supply. Since my last report the real yield of 20 year Linkers has been volatile but it is now back to +1.3%, and the yield curve is steeper.

Equity Markets

In this section on the outlook for equity markets I am going to look at relative valuations first then the outlook for earnings growth and past profit margins and then I will have a look at the sector allocations of the regional equity indices.

Chart 13 shows valuations based on P/E ratios of regional equity indices, the left-hand chart suggests that the US remains and now global equities are expensive relative to last 30 years and as we have seen from this chart before, Europe, UK, EM and China appear cheap. The right-hand chart shows just how extreme the relative value of these regional indices has become between the US and Europe, the UK and China.

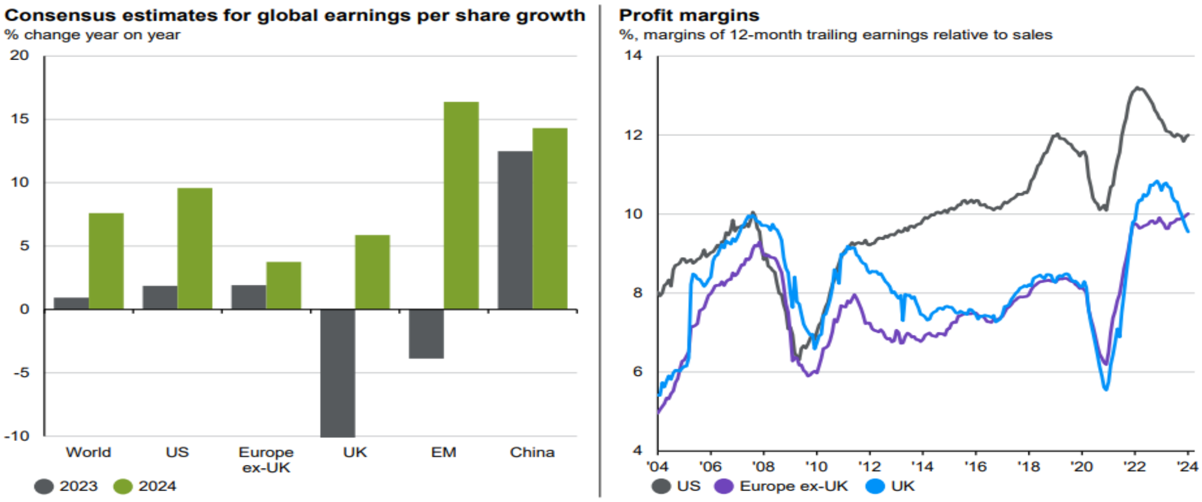
Chart 13: - Regional equity indices; Valuations based on Price/Earnings Ratios, since 1990, China 1996



Source: - JPM Asset Management, 8th February 2024

Chart 14 shows earnings growth expectations for 2023 and 2024 and profits margins of the companies in the same regional indices. In terms of earnings per share growth for 2024, expectations in all regions have been revised down and 2023's downward revision should be reflective of the of 4Q23 and full calendar year actual reporting. The right-hand chart shows profit margins in the US and UK have also fallen in the last year as higher costs have impacted companies. Although interestingly Europe seems to have avoided this, probably due to the different treatment of employees during Covid. What does appear clear from profit margins is that since 2012 companies quoted on the US S&P 500 index have been more profitable than their UK and European counterparts. This could go some way to explaining why investors are willing to accept the higher aggregate P/E ratios of the US index. What is also clear from recent new listings (IPO's) is that investors on US stock exchanges are willing to pay higher P/E multiples for new companies. The higher P/E ratio of the MSCI World index is probably a co-incident effect, because of the high weight of the US in the world index.

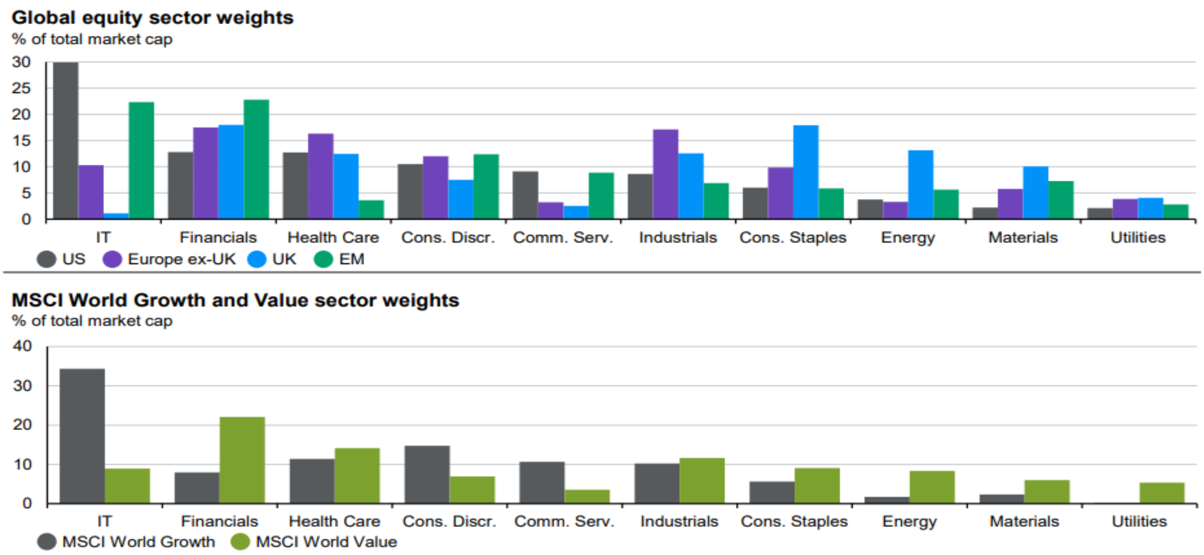
Chart 14: - LHS Earning per share growth rates, RHS Profit margins; for various regional equity indices.



Source: - JPM Asset Management, 8th February 2024

If profitability is not the whole answer maybe it is the index construction itself that has a part to play in the valuation of the S&P 500 and the MSCI World indices. I have highlighted the dominant regional weight of US listed companies in the world index. If we drill down into the distribution by sector this shows another bias, as chart 15 below shows the US S&P index is dominated by IT and Communications Services companies, it also has high weights to Consumer Discretionary and Health Care companies. As a result, these sectors also have a high weight in the MSCI World Growth index. These sectors have enjoyed strong growth and profitability over the last 10 years. While the European index is better balanced between all sectors it still has a much lower weight in IT and consumer services and its largest weight is in Industrials. The UK's FTSE All-share index has by contrast almost no companies in the IT sector and the highest weights to Consumer Staples, Energy and Materials all of which also have high weights in the MSCI World Value index.

Chart 15: - Sector weight is regional and world indices



Source: - JPM Asset Management, 8th February 2024

I don't know if the global mega-stocks can continue to be as profitable, but their dominant position in the global economy may suggest a global equity investment approach could be more appropriate than one based on specific regional allocations.

Equity Market (Growth Assets), Recommendations

In the fourth quarter the Fund decided to change it strategic asset allocation to reflect the improved funding level, a lower appetite for risk and a desire to increase the total return from income rather than growth assets. From the 1st of April the Fund will start the phased transition to a lower equity market allocation reducing growth assets from 55% to 50% over the next 2 years. This will be achieved by reducing the allocation to UK equity and folding the stand alone allocations to Japanese and Emerging market, equity into Global sustainable equities and increasing the exposure to Private equity. In light of these strategic changes, I am not making any suggestions for new tactical changes to how the growth asset allocation of the Fund is currently distributed.

The changes to the Fund's strategic growth and income allocations are consistent with my previous suggestions to have a greater tactical weight to income assets.

While noting my comments above about global equity long term performance I remain comfortable in the short term, with a 2% underweight allocation to global sustainable equity because of the strategy's higher interest rate sensitivity. I am also happy to remain overweight to UK equity due to the extreme relative valuation discount for the UK relative to the US (and by proxy) the World index as noted the RHS of chart 13 above. I also recognise that the strategic changes being adopted outweigh my tactical suggestions and will lead to an increased strategic exposure to Sustainable equity and lower exposure to UK equity.

Income Assets

The new Strategic asset allocation increases the weight to income assets from 25% to 27.5% in the next year and to 30% the year after. While these strategic changes are consistent with my previously suggested tactical 27% allocation, I am suggesting a reduced overweight to the MAC allocation of +1% down from +2%, because of the recent strong performance of high yielding assets. The strategic changes, increase the allocation to MAC by 0.5%, infrastructure by 1.5% and property by 0.5% this year. Broadly speaking my new tactical MAC allocation of +1% is consistent with this. It will also take some time to increase the infrastructure and property allocations. I still believe MAC remains attractive, relative to longer duration, more interest rate sensitive assets, just not ss attractive in the short term as it was.

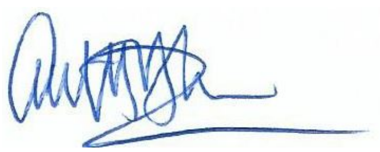
Asset Allocation

The asset allocation set out in table 8 below, shows the new Strategic Asset Allocation Benchmark that comes into effect on the 1st April 2024 and my suggested weights relative to the new benchmark. These allocations represent an ideal objective for the Fund based on my expectations for economic growth and market performance, but they do not take into consideration the difficulty and costs in reallocating between asset classes and the time needed by the In-house Team, their Pooling partner and investment managers to find correctly priced assets for inclusion in the Fund.

Table 8: - Recommended asset allocation against the Strategic Benchmark.

The 2 righthand columns show my suggested allocations relative to the new strategic benchmark that comes into effect on the 1st April 2024.

% ASSET CATEGORY	NEW DERBYSHIRE STRATEGIC WEIGHT 1ST APRIL 2024	ANTHONY FLETCHER 16TH FEBRUARY 2024
Growth Assets	**52.5**	**-1.0**
UK Equity	**10**	**+1.0**
Overseas Equity	**42.5**	**0**
Japan	2.5	**0**
Emerging markets	2.5	**0**
Global Sustainable	31.5	**-2**
Global Private Equity	6	**0**
Income Assets	**27.5**	**+1**
Property	9.5	**0**
Infrastructure	11.5	**0**
Multi-asset Credit	6.5	**+1**
Protection Assets	**18**	**0**
Conventional Gilts	6	**0**
UK index Linked	6	**0**
US TIPS	0	**0**
Investment grade credit	6	**0**
Cash	2	**0**



Anthony Fletcher

Independent External Adviser to the Derbyshire Pension Fund

Appendix

References

Source material was provided by, including but not limited to, the following suppliers: -

- Derbyshire Pension Fund, PEL performance services
- FTSE and ICE Indices
- JP Morgan, Asset Management
- Bank of England, UK Debt Management Office, UK OBR, UK Treasury, ONS
- US Bureau of Labour Statistics, US Commerce Dept. The US Federal Reserve.
- Bank of Japan, Japan MITI
- ECB, Eurostat
- Bloomberg, FactSet, Markit and Trading Economics
- Financial Times, Daily Telegraph, Wall Street Journal, New York Times, Washington Post