Oxfordshire County Council Pension Fund

Quarterly Investment Report

Q3 2024

Contacts

John Arthur

Senior Advisor
+44 20 3327 9720
john.arthur@apexgroup-fs.com

Anita Bhatia

Senior Advisor

Anita.bhatia@apexgroup-fs.com

Whilst care has been taken in compiling this document, no representation, warranty or undertaking (expressed or implied) is given and neither responsibility nor liability is accepted by Apex Group plc or any of its affiliates, their respective directors, consultants, employees and/or agents (together, "Protected Persons") as to the accuracy, efficacy or application of the information contained herein. The Protected Persons shall not be held liable for any use and / or reliance upon the results, opinions, estimates and/or findings contained herein which may be changed at any time without notice. Any prospective investor should take appropriate separate advice prior to making any investment. Nothing herein constitutes an invitation to make any type of investment. This document is intended for the person or company named and access by anyone else is unauthorised.

Apex's Investment Advisory business comprises the following companies: Apex Investment Advisers Limited (no. 4533331) and Apex Trustee Services Limited (no. 12799619), which are limited companies registered in England & Wales. Registered Office: 6th Floor, 125 London Wall, London, EC2Y 5AS. Apex Investment Advisers Limited (FRN 539747) is an Appointed Representatives of Khepri Advisers Limited (FRN 692447) which is Authorised and Regulated by the Financial Conduct Authority.

APEX

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)	J.P. Morgan Government Bond Index Emerging Markets Core Index	8.56%	4.61%
EM Gov Bonds (Hard/USD)	J.P. 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%

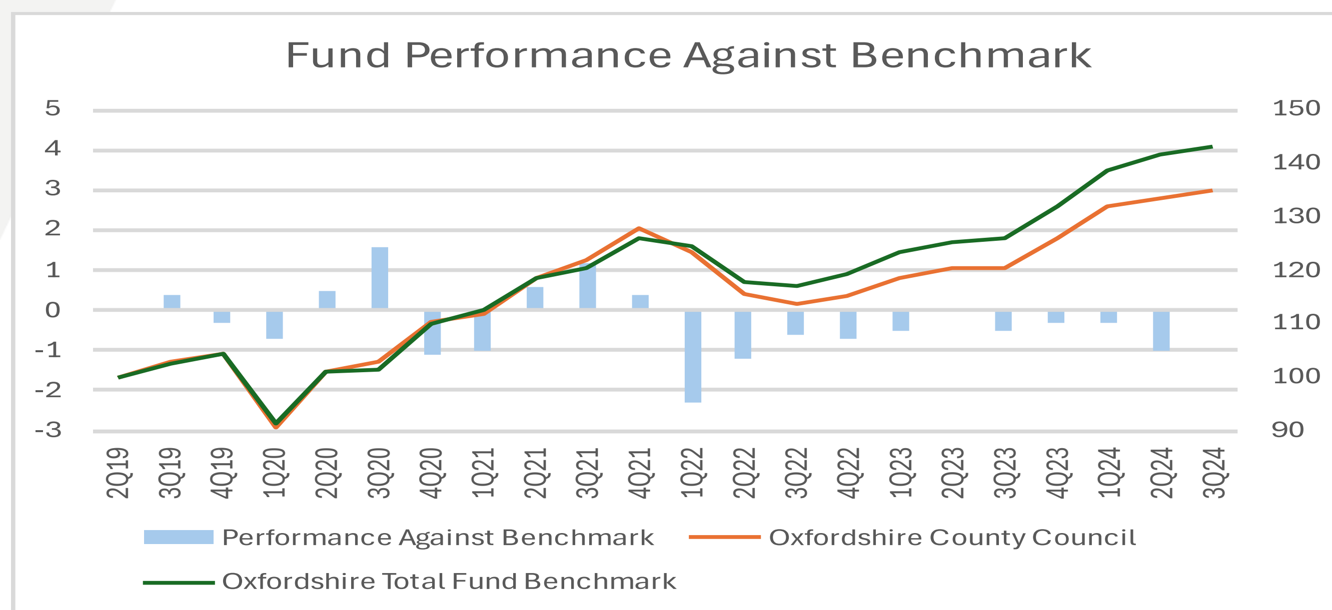
Source: Bloomberg. All return figures quoted are total return, calculated with gross dividends/income reinvested and in local currency.

APEX

Performance

The Fund rose by 1.1% in the third quarter of 2024 to a value of £3.566bn. This is an all-time high. As can be seen from the previous page, almost all asset classes continued to generate positive returns over the quarter. For the Fund this was partially offset by the strength of Sterling which rose over 5% against the US Dollar and was strong against the Euro. Because a large percentage of the Fund is held in overseas assets, they are affected by exchange rate changes and, in particular, by changes in the GBP/USD exchange rate as the US accounts for over 70% of the main global equity indices. This concentration of global equity markets in one region is at an all-time high and has been driven by the strong performance of US equity markets over the last decade. I note that the US Dollar has strengthened considerably post quarter end and the election of Donald Trump as US President with his more protectionist economic agenda, I suspect this US Dollar strength will continue for a while yet but will eventually reverse.

Chart 1: Oxfordshire Pension Fund Performance



The chart above shows the performance of the Total Fund against its Strategic benchmark rebalanced to 100 (the lines) on the right hand scale and the Fund's relative performance against its strategic benchmark (in blocks) on the left hand scale. All of the Fund's underperformance has occurred since the transfer of assets to Brunel and, in particular, since the Russian invasion of Ukraine in 2021 and the subsequent rise in inflation and then interest rates and has it is this that has driven the poor performance of their selected managers particularly within the main active equity portfolios. Because of this the Fund continues to lag its benchmark over the longer term, underperforming over 1 year (by-1.6%) over 3 years (by -2.4%); 5 years (by -1.1%) and 10 years (by -0.1%).

Over the last 3 years the performance of the underlying managers selected by Brunel has been disappointing with approximately half the total underperformance of -2.4% relative performance against the Strategic Benchmark coming from the performance of the two main Global Equity portfolios, Sustainable and Global High Alpha. However, I believe this to be heavily influenced by the strong environmental slant which is a core part of Brunel's ethos. I continue to support this environmentally focused slant for the longer term, however, the poor performance is showing no signs of recovery at present and Brunel need to be challenged on this.

Returns of 7.6% per annum over the last 10 years, being above the Fund's actuarial discount rate assumption for future investment returns, will have helped improve the funding ratio between the triennial actuarial revaluations.

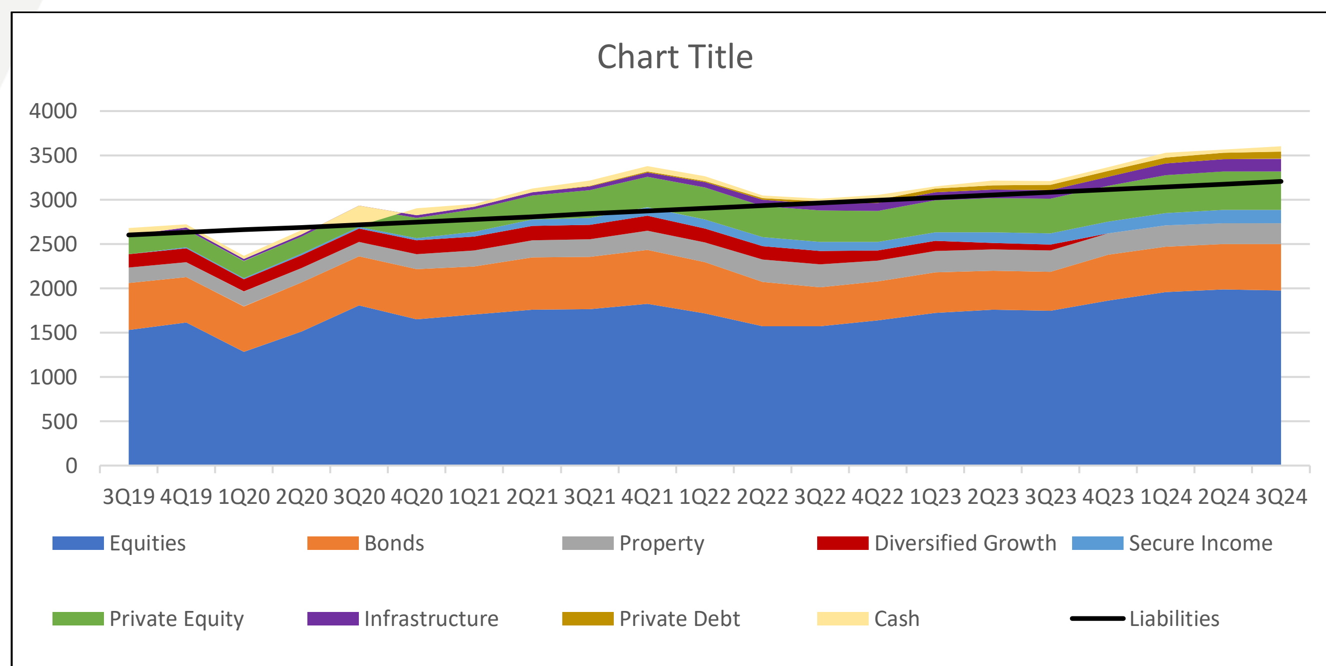
APEX

I note the recent resignation of Brunel CIO David Vickers, this is a disappointment and underlines the rapid turnover in senior posts experienced across the LGPS pools. Given the Government's intention to push further responsibilities into the pools this raises a concern.

Comment

The chart below shows the assets of the Fund by asset class with the Fund currently at an all-time high valuation of £3.606bn as at 30/9/24. I have also shown a black line which is the assumed valuation of the liabilities. Please treat this with some caution, the liabilities are valued by the actuary every three years. At this time they calculate the value of all earnt pension benefits plus the expected value of all future pension entitlements by the existing membership. This future liability is discounted back to today's value using a discount rate which reflects market conditions on the day of the valuation so, in essence, a snapshot every three years. At the time of the actuarial revaluation, the actuary also calculates the future investment return which gives them the required probability of maintaining full funding into the future. To create the line in the chart, I have compounded up the valuation of the liabilities by the required investment return for each quarter, changing the rate from 4.4% per annum set in the 2019 actuarial revaluation to 4.0% per annum when it was updated at the time of the 2022 actuarial revaluation.

Chart 2: Oxfordshire Pension Fund Assets



As bond yields have risen since the last actuarial revaluation it is likely that the actuary will use a higher discount rate to value future pension liabilities when they revalue the liabilities on 30/3/25. this will reduce the current valuation of future pensions in today's money and, thereby, will increase the funding level of the Fund all else being equal, but will also require a higher investment return going forward. There are also a number of other assumptions that the actuary makes when calculating the value of the pension liabilities including longevity and I have not made any estimation for these.

Long Term Capital Market Assumptions

Each year, J P Morgan Asset Management produce a report (now in its 29th year) on their Long-Term Capital Market (LTCM) assumptions complete with expected risk and return forecasts for each asset class and correlations across asset classes. They target a time horizon of 10 to15 years for these assumptions. Their report is the most comprehensive and detailed of any LTCM forecasts produced and the team of Investment Advisors at Apex discus this report in detail and use it as the starting point for our own assumptions.

This year's report is particularly interesting as, with interest rates now higher, J P Morgan do acknowledge that we are in a different regime to the low investment, low economic growth and low interest rates of the 2008 to 2022 period. Their report is predicting slightly higher investment returns across many asset classes driven by a view that we are now entering a period of higher investment and higher growth as governments continue to shift from austerity to fiscal activism and the massive investment into Artificial Intelligence (AI) begins to pay off. J P Morgan have increased their assumption for economic growth in the developed world by 0.2% per annum due to the benefits that they believe AI will deliver to the wider economy.

Given the rise in equity markets during 2024 (up 20%+ at the time of writing) you would have expected long-term return forecasts for global equities to be lower this year as we are starting from a higher valuation level but, due to the higher rate of economic growth assumed, this is not the case.

The J P Morgan view highlights the core discussion points about future returns in my mind and focuses on three interlinked issues:

1. Can governments continue to increase spending given their already high debt levels.
2. Will that spending be aimed at investment and raising the long-term economic growth potential or at the political expediency of boosting short-term demand, which is inflationary, rather than growth orientated.
3. In a more polarised world with shifting political relationships will corporates believe there is enough economic and political stability to increase investment.

As we saw with the Liz Truss budget and again with recent discussions following the Racheal Reeves budget for the new Government in the UK, lenders will only lend if they believe that the extra borrowing is targeted at investment which delivers higher long-term economic growth thereby generating the increase revenue to service that higher debt. We are re-entering a world of the bond vigilante where bond managers are the arbitrators of a governments ability to borrow. The higher borrowing will keep interest rates high at longer maturities and the tightrope that governments have to walk to borrow as much as they wish, whilst retaining the confidence of bond markets and staying onside with the bond vigilantes, will keep bond yields volatile.

The UK is an interesting case study in this dynamic. Liz Truss got it wrong by not providing enough detail of how greater borrowing would boost economic growth and not putting guard rails around her desire to increase borrowing into the future, this undermined lenders confidence in the UK Government's ability to service the higher debt levels without printing more money which would weaken the value of Sterling reducing the return for international investors on which the UK relies.

With the recent budget from Racheal Reeves, it feels like the jury is still out but that she has got away with increasing the UK's borrowing (for now). Whilst some of the increased borrowing is targeted at solving inherited issues, it is noticeable that, of the extra £70bn of annual government spending forecast in the budget, 2/3rds is going on current spending, boosting short-term demand and only 1/3rd on capital investment, growing the UK's economic capacity in the future. Partly because of this the Office for Budgetary Responsibility (OBR) forecasts a short-term boost to the UK economy with GDP growth of 2% in 2026 but no improvement in the longer term growth outlook suggesting limited extra revenue to service the increased debt levels. It is this calculation which has pushed UK Gilt yields higher since the quarter end.

Chart 3: UK 5-year Gilt yields

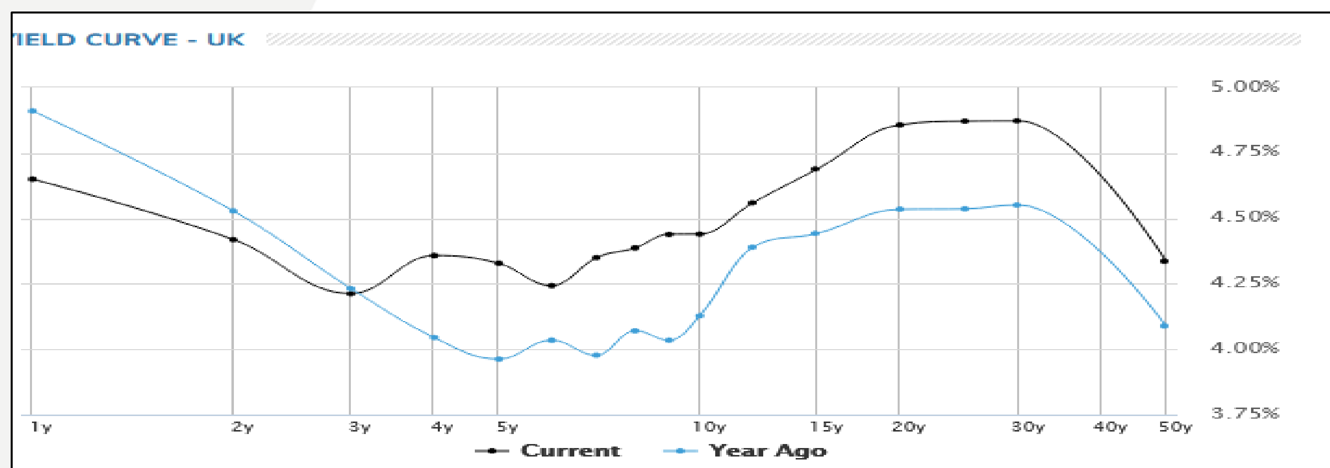
As can be seen on the right hand side of the above chart, 5-year UK Gilt yields have risen almost a full percentage point since the end of the third quarter. This has been in an environment of rising bond yields globally but is more extreme than elsewhere suggesting lenders are concerned by the extra borrowing and accompanying higher UK Gilt issuance which the market will need to digest following the recent budget. Remember this higher issuance is coming at a time when Quantitative Easing has ended and central banks are not now the default buyer of Government debt.

A similar, if slightly less extreme rise in US Treasury yields has occurred since quarter end for much the same reason. Lenders see a Trump presidency as potentially inflationary with corporate and personal tax cuts boosting growth but reducing government revenues; a less independent US Federal Reserve (US Fed) setting interest rates too low for the underlying economic conditions to boost short-term growth; trade tariffs raising costs and prices and the deportation of 1 million undocumented immigrants reducing the labour pool and leading to higher wages. In addition, I suspect an uncertainty premium is also being built in to reflect President Trump's unpredictable and unconventional approach. The rise in yields here since quarter end has been nearer 0.75%.

Chart 4: US 5-Year Treasury Yields

It is now up to lenders and their bond managers to set how much they will finance Government spending and at what cost. So far the expectation remains that interest rates will continue to fall but longer duration bond yields are signalling that inflation is still a worry.

Chart 5: UK Yield curve current v one year ago.



The chart above shows the change in UK Gilt yields across maturities over the last year with the front end falling as interest rates are cut but yields rising at longer maturities as investors question the inflation outlook.

For the UK, it would seem possible that a Trump presidency will be negative for UK growth with potential trade tariffs and greater spending required on UK defence, suggesting that interest rates may now fall faster than expected as the UK economy slows. This is positive for shorter-dated UK bonds whilst longer-dated yields will remain higher due to the raised inflation threat and higher Government borrowing requirement. The last resort of governments or presidencies who are unhappy with the cost of their debt is to force domestic asset owners to buy more of it – you have been warned!

Table 1: J P Morgan LTCM assumptions for 2025

Returns forecast in Sterling	2024 LTCM forecast	2025 LTCM forecast	Annualised Volatility
UK Cash	2.8%	↑ 2.9%	0.7%
UK Gilts	4.5%	↓ 4.2%	7.7%
UK Investment Grade Bonds	5.4%	↓ 5.2%	8.2%
UK Index Linked Bonds	5.3%	↓ 4.4%	11.2%
Multi-Asset Credit	6.3%	↓ 5.8%	8.8%
Global Equities	6.2%	↑ 6.3%	13.7%
Emerging Market Equities	7.2%	↓ 6.4%	17.9%
UK Core Real Estate	6.5%	↑ 7.6%	13.1%
Global Value-Added Real Estate	8.1%	↑ 9.0%	17.8%
Global Infrastructure	5.2%	↑ 5.5%	10.6%
Private Equity	8.1%	↑ 9.1%	17.2%
Private lending	6.9%	↑ 7.4%	15.4%
Gold	2.5%	↑ 3.3%	16.9%

As can be seen from the table above, investment return expectations for Bonds have fallen slightly as interest rates have fallen from recent highs but return assumptions for Equities and Alternative Assets have increased. J P Morgan have raised there expected Global Equity return on the back of greater investment and the benefits of AI but this only accrues to Developed Equity markets, expected returns on Emerging Market Equities fall. Alternatives see slightly raised return expectations across the board following a couple of more muted years with UK and International Property and Private Equity in particular looking attractive.

My personal view is that I am not yet convinced about the higher economic growth argument and see current valuation levels for equities as high, particularly in the US. A Trump presidency may be good for the corporate sector with lower taxes and greater protectionism but ultimately I do not believe this will be sustainable with markets eventually forcing economic

orthodoxy to deliver more sustainable economic growth rather than a series of sugar rushes. Given the lower volatility experienced in Bonds against Equities and the relatively small difference in return expectations, I have a marginal preference for Bonds over Equities for a while yet but recognise that I have been over cautious in the past! What the J P Morgan report does suggest is a preference for real assets to combat the higher and more volatile inflation threat and I agree with this view. They also suggest an improved outlook for Private Equity as deal flow improves and funds are able to realise existing investments. Again I agree.

Politics very rarely affect investment markets in the longer term but there is an increasing probability that President Trump may be different due to his non-conformist approach and short-term focus. His selections for various Secretary of State roles suggest loyalty is valued over experience or, potentially, ability. The problem with appointing a team around you on the basis of loyalty rather than competence is that, firstly, you do not necessarily end up with competent people and there is no obligation for them to become competent as this is not a trait which is valued and, secondly, if the team around you will always agree with you then there is limited progression of thought and understanding as there is no challenge. Much of the agenda President Trump has set out so far is inflationary. It may provide a short-term boost to markets but will not be sustainable and ultimately is likely to lead to a painful dénouement with higher interest rates or a much weaker US Dollar. Such a scenario would be damaging to most asset classes including both Equities and Bonds. Again, this concern should lead the Fund to focus on real assets which have an element of inflation protection and to be wary of being over exposed to the US. This is particularly the case given that US equities account for approaching 70% of the MSCI World Index.

Asset Allocation

Table 2: The Fund's current asset allocation against the Strategic Benchmark

Asset class	Asset Allocation as at 31/3/24	Strategic Asset Allocation	Position against the SAA	Deviation in cash terms
Equities	54.7%	**51%**	+3.7%	-£133m
Fixed Interest	14.7%	**16%**	-1.3%	+£47m
Property	6.5%	**8%**	-1.5%	+£54m
Private Equity	12.0%	**10%**	2.0%	-£72m
Secure Income	4.4%	**5%**	-0.6%	+£21m
Private Debt	2.3%	**5%**	-2.7%	+£97m
Infrastructure	3.5%	**5%**	-1.5%	+£54m
Cash	1.7%	**0%**	+1.7%	-£61m

These figures are taken from the State Street report. Figures may not add up due to rounding.

The current deviation from the Fund's SAA is within acceptable bounds although I would recommend taking the equity weighting back to the benchmark and reinvesting into shorter-dated UK Corporate Investment Grade Bonds particularly as this money has already been committed to invest into Alternative Asset Classes and is awaiting drawdown. Unfortunately Brunel does not currently offer such a product meaning the Fund would either have to procure a manager outside of Brunel or invest into the existing Brunel Sterling Corporate Bond fund which would mean taking duration risk. Brunel have appointed PGIM as their bond manager and I suspect it would be possible to approach them for a short dated bond fund, either directly or through Brunel, thus avoiding the need to conduct a procurement exercise. This holding would be temporary as the money would be drawn down into the Alternative portfolios over time.

APEX

Table 3: Allocations to Alternative Investments Invested/Committed

Market Value/Committed	Private Equity	Infrastructure	Secure Income	Private Debt
Direct by OCCPF	£290m	£37m		
Cycle 1 March 2018	£95.0m/£100m	£51.3m/£50m	£54.3m/£60m	n/a
Cycle 2 Apr 2020	£48.0m/£70m	General £17.4m/£20m Renewables £14.6m/£20m	£35.4m/£40m	£54.1m/£70m
Cycle 3 Apr 2022	£0m/£16m	£21.3m/£60m	£61.5m/£60m	£29.9mm/£90m
Brunel Total	**£143.0m/£186m**	**£104.6m/£150m**	**£151.2m/£160m**	**£71.6m/£160m**
Awaiting Drawdown	**£41m**	**£73m**	**£0m**	**£50m**

These figures are based on a number of assumptions and should be used as a guide only.

Based on my calculations the Fund has approximately £165m of outstanding commitments to the Alternative Asset Classes through Brunel which has yet to be drawn down. This money is currently being held in global equities which have risen in value over the last few years. Given high valuations and an element of political uncertainty, I would recommend switching this money into a less volatile asset as noted above.

Points for Consideration

1) Performance of the underlying portfolios continues to be poor across much of Brunel especially within Global Equities which is where a substantial part of the Fund is invested. There are detailed reasons why this has happened, much of which is due to the strong Responsible Investment and ESG philosophy which Brunel has adopted. However, the continued underperformance across a number of portfolios brings into question Brunel's ability to select investment managers who can outperform over the longer term. The Pensions Committee should remain cognisant of why this underperformance has happened and continue to challenge Brunel over performance issues.

   Question for Brunel:

   a: How do you select investment managers, what role does past performance play on that selection?

   b: Please talk through an occasion where you have sacked a manager, what had changed from your initial appointment, what had you got wrong?

2) Recent discussions I have had with Brunel have underlined just how central their environmental focus is to their selection of investments managers. I do not now see Environmental, Social and Governance (ESG) factors as part of the criteria they use for selecting managers but as an initial screen setting a high bar for those managers to be considered for selection. Brunel would not employ a manager that could not complete the level of ESG reporting they require irrespective of how strong they appeared outside of this criteria. This strong ESG ethos will likely remain the defining factor on future performance against more ESG neutral benchmarks and peer groups.

   Questions for Brunel:

   a) How do you include ESG and Responsible Investment factors in your manager selection process?

   b) A strong ESG bias in investment has seemed to be a negative in performance terms over the last three years. What do you expect will change this pattern?

   The committee need to feel confident, not just in the inclusion of ESG factors in the selection of investment managers, but in the way Brunel approach this.

3) UK Equity Mandate (Brunel): The Fund is currently invested in UK Equities via an actively managed mandate through Brunel. This mandate is benchmarked against the FT All-Share ex Investment Trusts Index which includes all companies quoted on the UK's main market. The largest companies quoted in the UK are focused around the Oil,

Banking and Mining industries with very little exposure to technology companies. This bias means a UK portfolio selected from stocks within the FT All-Share is likely to have some focus on cyclical industries and have relatively high carbon emissions.

Given the Fund's UK base there is some benefit in holding UK assets but better performance over the long-term with a lower carbon impact is likely to be found in the smaller companies' space and, as such, it would make sense to switch this mandate to the FT 250 or FT Smaller Companies Index. This is highly likely to require a change in managers but, in my opinion, is likely to increase the probability of the portfolio outperforming the benchmark over time.

Brunel are currently undertaking manager selection for this mandate with a view to completing this by year end and transitioning to the new managers early in the new year.

Questions for Brunel:

a) Please update the Committee on progress to appointing managers for this portfolio

b) What are the areas where you expect managers to add value within a UK smaller companies portfolio?

4) Alternative Investments: Brunel accept that the current figures produced for drawdowns to and distributions from the Alternative Asset portfolios are inadequate for a Fund to be able to create a useful cash flow forecast from these asset classes. They are working to improve their processes and the quality of information they provide to member funds. I will continue to push for better data in this area. It would make sense, now the initial investments into Alternative Asset Classes have been made, for Brunel to move to an evergreen funding process where, rather than member funds committing to individual funds over a succession of vintages in Infrastructure, Private Equity and Private Debt, Brunel provide one unitised wrapper in each of these asset classes and manage the member funds' cash flow requirements into and out of each Alternative Asset Class directly. This would reduce the administrative burden on your Fund's officers and could simplify reporting.

APEX

Underlying Mandates

Rather than comment on each portfolio separately, duplicating the reporting from Brunel, the table below sets out each portfolio within the Fund with a note on my opinion of the management and performance using a traffic light system. Because of the transfer of assets to Brunel all the portfolios will have changed manager over the last four years. For this reason I have rated some of the portfolios amber purely because the performance history is too short to support an opinion.

We now have 3-year performance figures for both Private equity and Infrastructure and, whilst the initial drawdowns to these portfolios were slow and Brunel's speed of commitment was initially poor this has now speeded up and performance figures do suggest that Brunel are achieving a reasonable level of return from these asset classes.

Portfolio	Benchmark	Inception	Performance	3 y relative	Comment
UK Equity	FT All-Share EX IT	09/18		-1.0%	Performance has been below benchmark across all time period but appears to be recovering.
Global High Alpha	MSCI World Equity	09/19		-3.8%	Underperformance over three years of -3.8% but outperformance since inception in 6/19
Global Sustainable	MSCI All World Equity	09/20		-6.5%	Performance a major concern with the portfolio underperforming by 5% since inception in 10/20
Global Paris Aligned	MSCI Paris Aligned	07/18		n/a	Passive portfolio, yet to reach 3 year figures. I have some concerns over portfolio construction.
UK Fixed Interest	£ Non-Gilt Credit	11/21		1.0%	Acceptable performance in a strong credit environment
Passive Index-Linked	FTSE >5 Year Index-Linked			0.1%	
Multi Asset Credit	Cash + 2%	11/21		-3.7%	Performance has lagged the benchmark since inception but appears to be recovering.
Property	Property benchmark	04/20		n/a	UK Performance has been good but poor in International Property lagging by 5%.
Secure Income	Cash + 4%	07/20		n/a	Noticeable performance issues
Infrastructure	CPI	01/19		n/a	Drawdown has been slow; performance looks OK
Private Equity	MSCI All World Equity	01/19		n/a	Drawdown has been slow; performance looks good for cycle 1 but poor for cycle 2.
Private Debt	Cash + 5%	08/17		n/a	Drawdown has been slow; performance looks good

Market Summary

- Q3 2024 saw cooling inflation and the subsequent easing of monetary policy across developed markets, most notably the US Fed's 50bps rate cut in September. The Bank of Japan (BoJ) 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).

APEX

- 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 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 US Dollar and 1.8% on the Euro. The Yen appreciated 10.7% versus the US 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 and c.1% positive real interest rates.
- **Elevated volatility characteristic of inflection points:** The VIX increased to 17 from 12 (+34.5%), 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. Iran reacted with a barrage of missiles launched against Israel, for which Prime Minister Benjamin Netanyahu has vowed there will be "consequences". While the economic impact has so far been muted, the potential for oil price increases were Israel to target Iranian production facilities is present and upside risks to inflation also exist through potential supply chain disruption in the Gulf of Aden and wider region.
- 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 US 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%). IT stocks posted minor growth, with utilities and real estate posting the strongest sectoral gains. Energy was the only sector to post a negative return. Early August saw a sharp selloff led by tech due to a confluence of factors including a rate hike by the BoJ, an unwind of the Yen carry trade, a weak jobs report, recession fears, and concerns over AI valuations. Equities recovered quickly thereafter. Joe Biden announced he would withdraw from the 2024 presidential election, which is now finely poised between Harris and Trump. Composite Purchasing Managers Index (PMI) which reflects economic activity was stable through the quarter, finishing at 54.4, again held up by services (55.4) versus weakening manufacturing (47.3 in September vs 51.6 in June).
    - The EuroStoxx 50 total return was 2.4% (YTD: +13.1%), with Eurozone stock returns led by real estate, utilities and healthcare. Both energy and IT delivered negative returns for the quarter. Composite PMI weakened through the quarter

to 48.9 (vs 50.9 in June) again held back by a Manufacturing PMI that remains well below 50 (45.0) however services also fell, moving from 52.8 in June to 50.5 by quarter-end. The French parliamentary elections in July resulted in no group achieving a majority, with the centre-right Michel Barnier appointed as prime minister in September.

  - In the UK, the FTSE all-share total return was 2.3% (YTD: +9.9%) and alongside the FTSE100 reached all-time highs. Equities were caught up in the global August volatility but generally traded sideways. Consumer staples, financials and consumer discretionary were the top performing sectors, with energy underperforming. PMIs remain above 50, notably with manufacturing rising from 50.9 in June to 51.5 in September. Services finished up on Q2 as well at 52.8. Labour won a landslide in the general election.
  - 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. As such, exporters were hit, and small cap stocks outperformed large cap. Markets stabilised towards the end of the quarter as concerns of a US slowdown reduced; however, a surprise result in the leadership race for the Liberal Democratic Party led to late declines. Corporate earnings however remain strong, and composite PMI ended at 52.5 for the quarter, with services (53.9) again outperforming manufacturing (49.7).
  - 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). By contrast Korea and Taiwan underperformed due to sector rotation away from tech. South Africa was also strong on the back of the smooth formation of the new government and rate cuts. India, Brazil, Colombia, Mexico and Turkey all underperformed.
- Yields fell as the rate cutting cycle began across many major economies, the most notable of which being the US Fed's 50bps cut, in-part motivated by rising unemployment. The Eurozone and UK both cut rates by 25bps amid lower inflation. Short-term data drove heightened volatility in developed market bonds through the quarter. US investment grade led corporate bonds, closely followed by US High Yield, with Europe and the UK behind but still positive and supported by strong / stable economic performance. The spread between 2-year yields and 10-year yields turned positive for the first time in over 2 years, supportive of a growing consensus of a soft landing.
  - 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. However, commentary late in the quarter contrasted with this by hinting at the potential for faster rate cuts.
  - US bonds (both government and corporate) outperformed their European counterparts, while emerging market debt was the strongest performer (+6.2% in US Dollar terms).
- Energy varied, with US natural gas up +12.4% and Brent Crude -16.9%. The Goldman Sachs Commodity Index declined 7.9%, with Energy the weakest component and agriculture, industrial metals and precious metals the strongest components.
  - US gas prices rallied +12.4%, continuing strong momentum from Q2, driven by high demand from AI-related consumption and the energy transition, geopolitical tension in the Middle East, lower US production and supply disruptions in Norway.
  - Brent Crude Oil prices declined sharply during the quarter (-16.9%). Despite supply fears due to heightened tension in the Middle East, sentiment was overshadowed by global demand concerns relating to manufacturing, particularly from China.
  - Industrials and precious metals performed well. Gold posted a gain of 12.7%, reaching all-time highs in large part due to market uncertainty / volatility. Aluminium, zinc, and copper achieved modest gains, while the price of lead declined.
  - In agriculture, the prices of coffee and sugar experienced noticeable increases, while soybeans and wheat saw slight declines.
- Global listed property rose, with the FTSE EPRA Nareit Global Index increasing by +9.6%.
  - The Nationwide House Price Index in the UK posted modest gains in July / August and rose 3.2% yoy in September.
- In currencies, the Japanese Yen had its strongest rally since 2008 as policymakers hiked rates alongside weaker US data with the US Dollar index weakening -4.8%. Sterling posted gains on the Euro (+1.8%) and US Dollar (+5.8%). Bitcoin

(+5.6%) performed well, however, the broader crypto ecosystem was more mixed with Ethereum falling -24% (YTD: +14%).