NEWS FROM THE INVESTMENT COMMITTEE

Q3 2022

News from the Investment Committee

The Investment Committee (IC) met on Thursday 23 July with the main task of reviewing the inputs and outcomes from the optimisation process for setting the 2022/23 strategic benchmark asset allocations.

This task was made more challenging given global markets have been navigating formidable crosscurrents over the past year – high inflation, supply chain bottlenecks, the war in Ukraine, a hawkish US Federal Reserve, and China's strict 'zero Covid' policy enforcing multiple lockdowns.

The most pressing single task for this year, and perhaps the most difficult to complete, rests with the Federal Reserve and other global central banks – namely, tightening monetary policy and hiking interest rates to tackle rapidly rising inflation pressures and slow demand. But with economic growth slowing, developed markets are facing – or already in – at least a mild aggregate demand related recession.

Given the global growth cycle is proving out of synch, expectations are for the UK and Europe to grapple with the same issues currently being experienced in the US, but probably six months later.

The particularly high inflation being experienced in the UK is most probably down to a unique combination of Brexit labour shortages, the ramp-up in demand post-lock down and the wider supply chain and sky-high commodity price issues. Whether interest rates will increase as sharply in the UK as in the US appears unlikely given the greater risk of a recession.

The IC discussed the continued suitability of the model's central inflation forecast of 2% p.a., given the current stagflationary environment, but noted that the model's optimisation process was largely unaffected by changing inflation assumptions in isolation. In addition, the Dynamic Planner wealth forecasts assume a 2.5% p.a. inflation assumption, thus providing an added degree of prudence in the long-term compounding calculations, given the current inflation pressures.

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Methodology enhancements for expected return assumptions

The IC has an ongoing responsibility to ensure the Benchmark Asset Allocation Process remains fit for purpose.

This quarter, the IC reviewed the results of enhancements made to the methodology for the determination of expected returns across the asset classes. The method is known as the Exponentially Weighted Moving Average and the parameter that controls the sensitivity to recent index data is referred to as Lambda. It applies greater sensitivity to more recent data inputs, than older ones in the series, when determining long-term average expectations.

While the IC had requested the necessary research work be conducted earlier in the year, the implementation of the amended methodology corresponded with unusually elevated levels of market volatility during Q1 and Q2 this year, albeit following an extended period of stability. As a result, there were changes to the expected return assumptions from the previous quarter's Capital Market Assumptions (CMA's) using the previous methodology. In the case of the bond assumptions, relative changes were higher for UK Index Linked Gilts, Stg Corporates and Global High Yield. For equities, the delta was largest for UK and Japanese equities.

After careful consideration, the IC was comfortable with accepting the inputs derived from the new methodology, as intuitively the results sent the correct signals for long-term investment decisions. The CMA's for Q3 2022, derived from the amended methodology, were approved.

2022/23 Strategic benchmark changes

In view of the heightened level of global economic uncertainty, after careful deliberation there was unanimous agreement to only make very minor changes. The key themes reflected in the strategic benchmark review can be summarised below:

- Minor increases in allocation for the lower risk profiles to cash from fixed interest and international equities
- No net increase in equity exposures, although still committed to the diversification of equity holdings globally
- Some minor re-balancing activities to re-centralise the benchmarks within their respective risk boundaries across profiles 2 - 7

Summary of changes by broad asset class

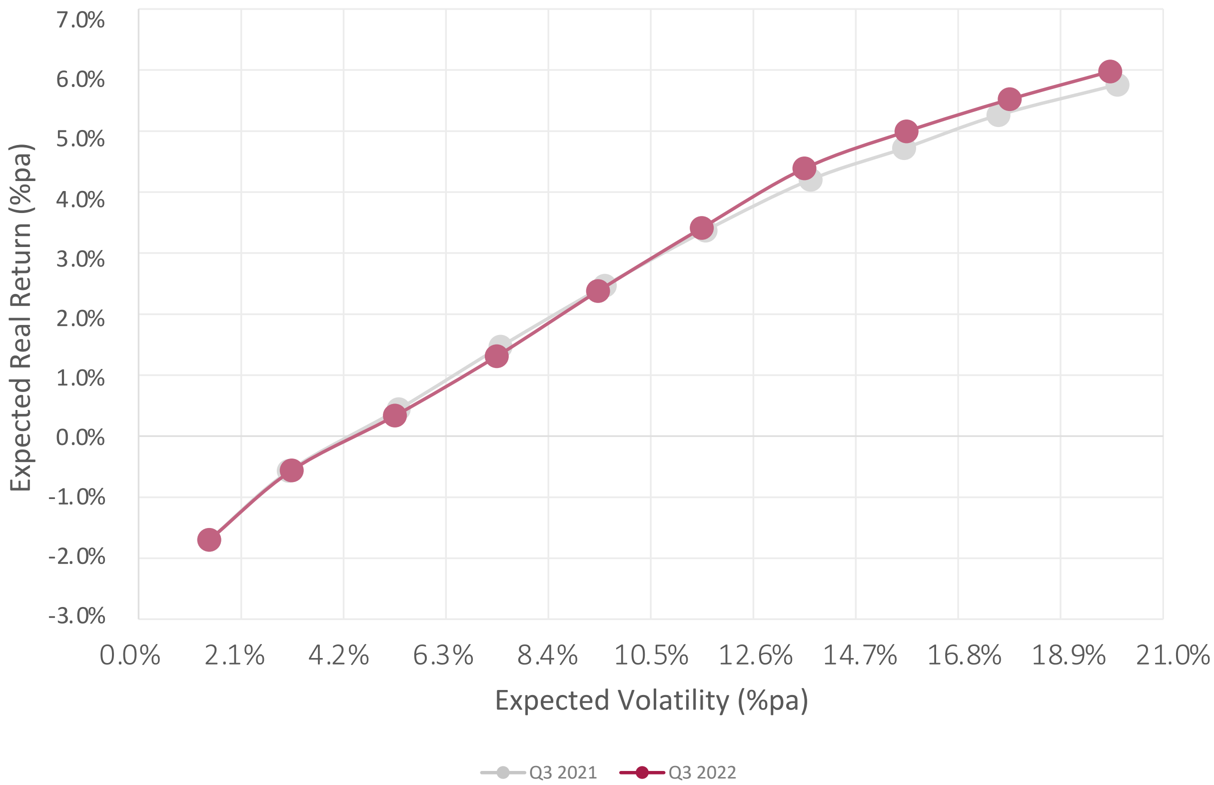
Risk Level	Cash	Fixed Income	UK Equities	International Equities
2	+1%	-2%	+1%	
3	+2%	-1%		-1%
4	+2%	-1%		-1%
5	+2%			-2%
6	+2%			-2%
7	+2%			-2%
8			+1%	-1%
10			+3%	-3%

These benchmark changes will be implemented by the MSCI Multi-asset index series as part of the re-balancing process for Q3 2022. They are also scheduled for release to all Dynamic Planner users from Friday 7 October 2022.

2022/23 Strategic benchmark changes – By sub asset classes

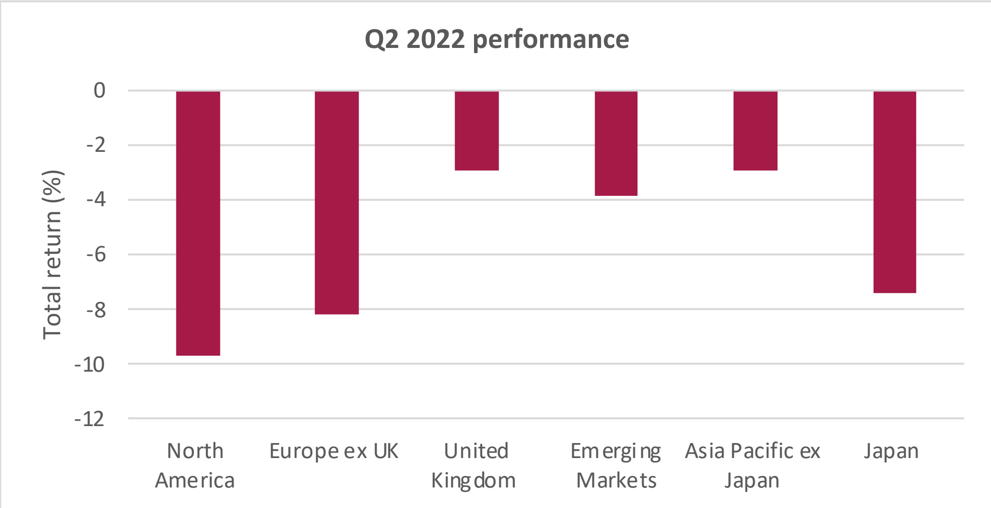
Risk Level	Cash (Deposits)	Cash (Money Markets)	UK Gilts	UK Index Linked Gilts	Sterling Corporate Bonds	Global Inv. Grade Bonds	Global High Yield Bonds	UK Equity	Europe Ex UK Equity	North American Equity	Japanese Equity	Asia Pacific Ex Japan Equity	Emerging Market Equity	Portfolio Turnover
2		+1%		-2%				+1%						+4%
3		+2%			-1%					-1%				+4%
4		+2%		-1%						-1%				+4%
5		+2%		-1%	+1%					-1%	-1%			+6%
6		+2%									-2%			+4%
7		+2%								+1%	-2%	-1%		+6%
8								+1%				-1%		+2%
9										-1%		+1%		+2%
10								+3%				-5%	+2%	+10%

Dynamic Planner efficient frontier



The previous quarter's market overview

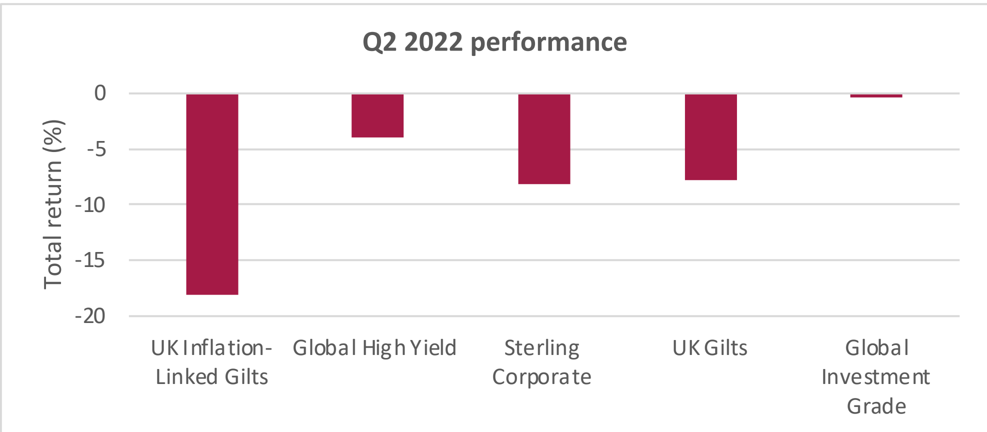
Equities



The tremendous rally from the pandemic lows of March 2020 seems a distant memory as equity markets suffered another drubbing this quarter.

Investor sentiment deteriorated rapidly amid concerns that growing inflation expectations and higher interest rates would result in a significant slowdown and even recession. The UK market, because of its high weighting in resources and value stocks, has however performed relatively well despite the pervading gloom.

Bonds



Given the ultra-low level of bond yields, it was not surprising that this environment of multi-decade high inflation and hawkish interest rate expectations prompted a sharp sell-off, most notably for UK index linkers, which, being long duration assets, are extremely sensitive to rate changes.

As economic indicators began to reflect moderating or slowing activity, bond markets did however manage to slightly recover some of the lost ground towards the quarter-end.

Review of the benchmark allocation performance

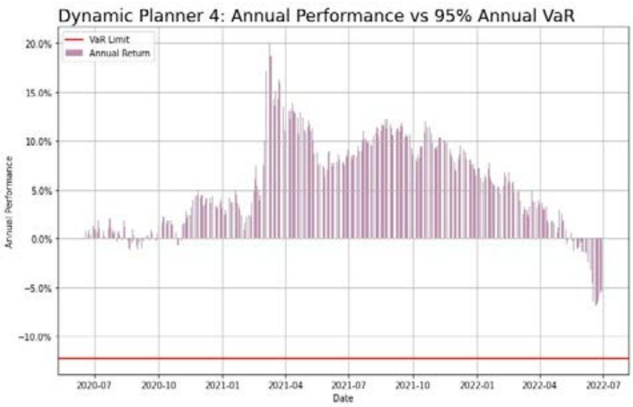
The outcomes of the benchmarks were reviewed and the IC noted the sharper drawdowns over the previous quarter experienced by the lower risk profile benchmarks, because of the recent rout in global bonds and their increasing correlation with equities which has manifested over recent years.

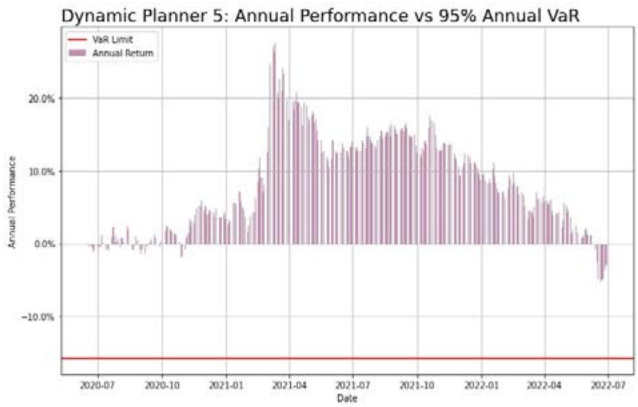
Various metrics were reviewed that validated the ex-ante and ex-post returns. The IC agreed that while, understandably, there had been more recent episodes of elevated volatility, drawdowns were within or close to expected VaR limits and the model provides long-term average expectations across the cycle.

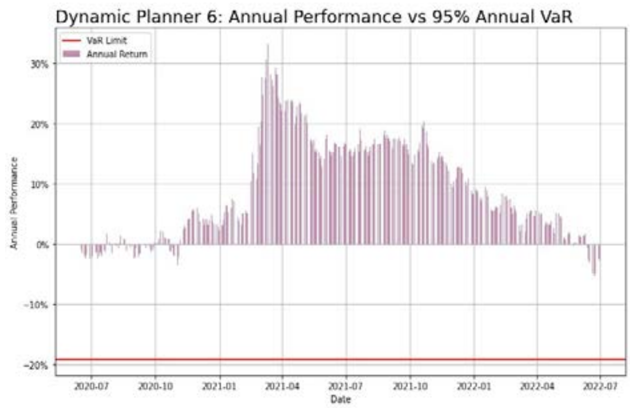
Monthly observed returns over last 12 months

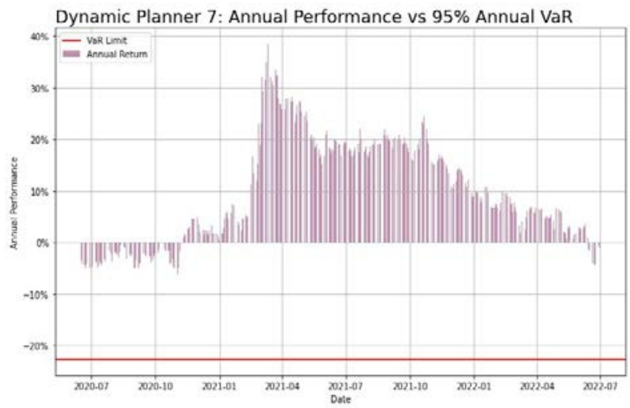
Annual Value-at-Risk analysis

Below shows how robustly the model has delivered against risk expectations, as demonstrated via the rolling annual returns calculated each day over the last two-year period versus their 95% VAR limit (the horizontal lines).









Dynamic Planner Investment Committee
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