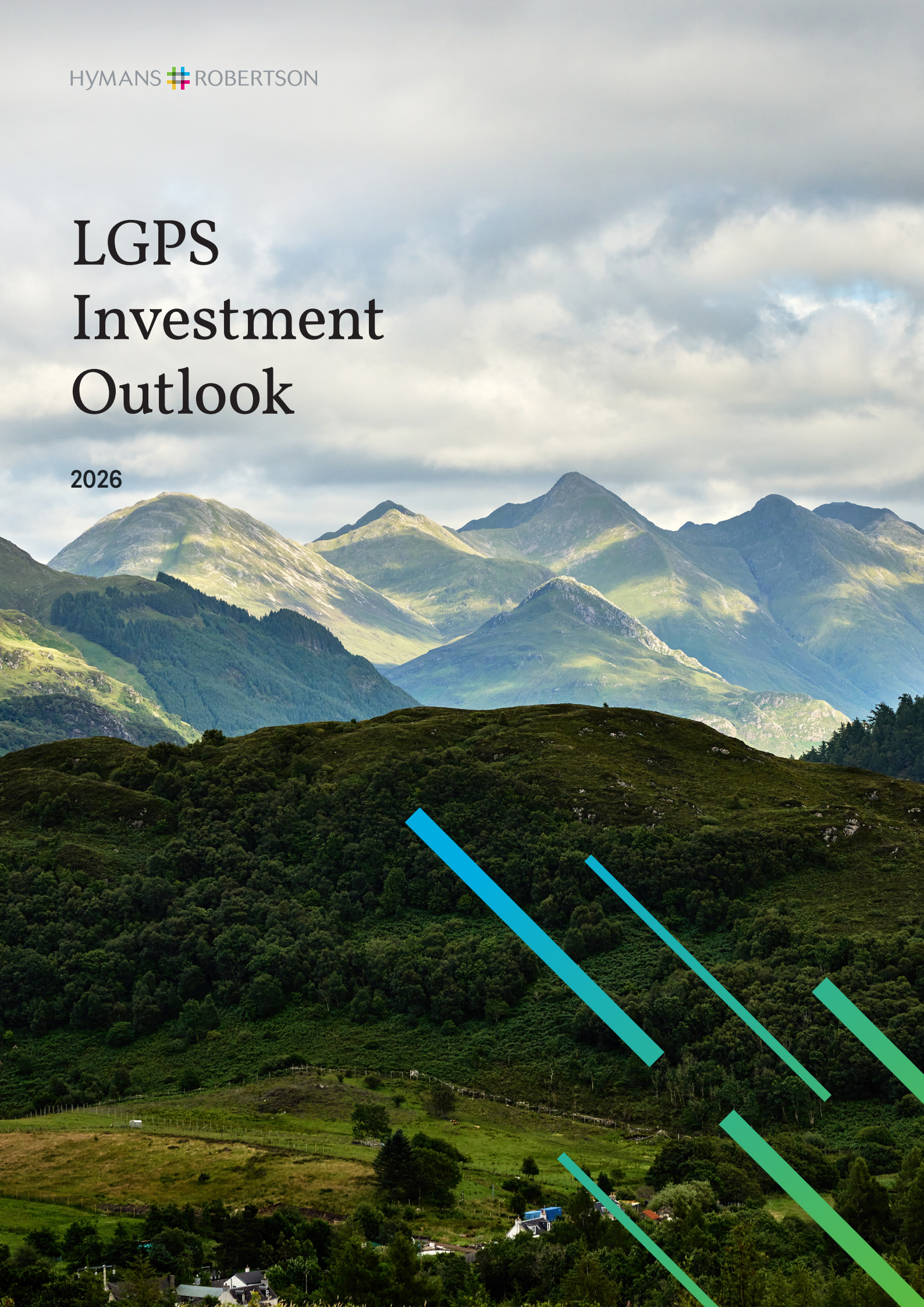


# LGPS Investment Outlook

2026







# Introduction

Welcome to this year's LGPS Investment Outlook. Before looking forward, it's worth looking back – and it's been some year for the LGPS!

For England and Wales, January started in the middle of the 'Fit for the Future' consultation, as the industry rushed to respond within the 10-week deadline to a range of questions on sweeping reforms to LGPS investment and governance.

All will be aware of how controversial many of these reforms have proven, not least because of the hazardous implementation timescales. The range and significance of investment decisions that pools would be responsible for also raised eyebrows, while the complexity of investing locally was contrasted with the opportunity it may present.

April brought the turmoil of two pools being instructed to disband, with the 21 funds of ACCESS and Brunel having to take their £100bn and select a new pool to join from the six remaining. This was to be done by the end of September. The process is now largely complete, with seven funds, all from ACCESS, choosing to join Border to Coast; seven funds joining Central (four from ACCESS, three from Brunel); six joining LPPI from Brunel; and the remaining Brunel fund, Buckinghamshire, selecting the London CIV.

At the end of May, we received the government's response to the consultation. As expected, the material concerns and opposition to the majority of reforms were noted, but government confirmed their intention to press ahead. The headline reforms would be brought into primary legislation through the Pension Schemes Bill, which is currently moving through parliament, with the detail to be provided in amended regulations and new guidance.

May also brought local elections in some administering authorities, with some funds seeing significant turnover in the membership and views of their pension committees. It's challenging to join a pension committee during such change, and new members have had to quickly get up to speed on the new requirements.

So where are we now? Funds are having to dedicate significant amounts of time to working with their pools to move into this new world. Those funds fortunate enough to not need to move pools have enough on their plate with the building of their pool's new capabilities, and the funds needing to join a new pool face the additional mountain of transferring and setting up. This is all taking place during an actuarial valuation year, which also involves subsequent reviews of the investment strategy.

At the time of writing, we are in the middle of another consultation, this time with a six-week deadline of 2 January. It's a technical consultation on the draft regulations to put these reforms in place, with three pieces of draft guidance also released two and a half weeks into the process, and with feedback requested by 12 January.

It was a quieter year for Scotland, as funds there prepare for another valuation year in 2026. However, interest in how the Scottish funds can better work together to invest more into Scotland certainly increased. Government wrote to funds to ask about their levels of investment into Scottish equities and infrastructure, and a number of events were held between the funds to explore ways to make this happen while still meeting fiduciary duty. Expect more to come in 2026.

Despite the challenges from these reforms, the LGPS continues to go from strength to strength. Funding levels are healthy, driven by strong investment returns during some very turbulent markets, also meaning the cost to employers continues to fall.

The LGPS still has a very strong and positive impact in the UK and globally with its investments, consistently raising the bar on sustainability, transparency and governance.

The pools are putting in huge amounts of work to meet the requirements placed on them by the 1 April 2026 deadline. In addition to the efforts of those needing to bring in new funds, we have seen large amounts of activity in recruitment and procurement, and plenty of meetings to work closely with partner funds to develop the new services in a way that works for them.

We have been constantly inspired by the way officers and committee members have kept a focus on their fiduciary duties and stakeholders throughout all of this change and uncertainty. Looking ahead, however these reforms pan out, we know that the LGPS remains in safe hands, and we are here to continue providing our support.

With these challenges front of mind, we've pulled together a selection of articles that will hopefully inform and assist your planning for the year ahead:

- ◆ **Are your fund's investment governance arrangements also 'Fit for the Future'?** by Kenny Taylor, Senior Investment Consultant
- ◆ **Local investing in 2026: turning strategy into action** by Sanjay Joshi, RI Consultant
- ◆ **Pool oversight – what you need to know** by Andrew Johnston, Partner and Senior Investment Consultant and Will Brammar, Investment Consultant
- ◆ **What do you do when your investment is performing strongly?** by Elaine Torry, Partner
- ◆ **Capital markets update** by Chris Arcari, Head of Capital Markets

**I hope you find these articles both interesting and informative. Should you wish to discuss any of these topics, please don't hesitate to reach out to me. Last but not least, here's to a prosperous 2026 for the LGPS.**



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# Are your fund's investment governance arrangements also 'Fit for the Future'?

There's no going back now: pooling is here to stay. The government is keen to press ahead with its 'Fit for the Future' changes, and with a real sense of urgency too. Some would argue (rightly or wrongly) that pooling needed this final push from government. It gave clarity, allowing the pools to implement their strategic plans with greater confidence to deliver the scale and benefits originally envisioned in 2015. At the same time, the government's changes are being implemented at a breakneck pace. The implementation timetable shows no lack of ambition – a lot of changes are being made over a short period. It's important to pause and take stock of what this means for how your investments will be governed.

## What is the role of the pensions committee from April?

Put simply, accountability for the fund's investment strategy remains with the pensions committee.

The pool will become the principal source of strategic investment advice to the committee, but the committee makes the decisions. The pool is responsible for implementing the strategy once agreed.

The committee will continue to set the fund's high-level investment beliefs and objectives, including responsible investment (RI) and net-zero commitments, and will define local and impact investment priorities.

To support this, the committee will need to maintain knowledge and understanding through structured training on pooling arrangements, governance and ESG principles. Further support will be provided through the appointment of an independent adviser. Final details are still to be published, but the government has made it clear that the independent adviser will be a non-voting role.

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### Your checklist of immediate actions

- ◆ Provide training for your committee on future roles and responsibilities
- ◆ Engage with your pool to understand plans and the timetable for delivering strategic investment advice
- ◆ Monitor requirements for the appointment of an independent adviser to support the committee
- ◆ Develop training plans to support upcoming investment activities

## How can you ensure that your views are properly reflected in solutions developed by the pool?

The pool is there to represent its partner funds, and there's an expectation that all parties will work together to find collective solutions. At the same time, the scale provided by pooling can be a bit of a double-edged sword when it comes to finding collective solutions. Scale gives access to a wider range of solutions and at lower cost, but it can also result in a more diverse range of views – particularly on RI issues, net zero and local investment. This can make it difficult to develop solutions without making compromises, as the process of pooling has shown so far. This could prove to be one of the more challenging aspects of the next stage of pooling.

From an individual fund perspective, it's important for the committee to continue to articulate its own views in these areas, so that these can be fed into the pool's overall policies and inform fund design. This could be an area where committees may wish to commission advice or support from outside the pool, either collectively or on an individual fund basis, to ensure that suitable external perspective is brought into discussions. However, the starting point is the committee's discussion.

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### Your checklist of immediate actions

- ◆ Articulate and document your beliefs and objectives to support future engagement with your pool
- ◆ Articulate your local and impact investment priorities, record in your ISS before 31 March 2026



## How can you assess whether your pool is delivering what you want and need?

It's not overstating things to say that the pool will become the fund's most important investment partner. The success of the fund's investment strategy relies heavily on the pool's actions – from the strategic advice they provide, to the implementation decisions they take on your behalf. Monitoring how the pool is performing will be a key governance activity in future. Any monitoring should consider operational, strategic and governance aspects.

There's a lot for the pools to consider and implement – pool company structure, services, recruitment and procurement are just some of the key items currently on a pool's 'to do' list. Against this background, it will be important for officers to have a thorough understanding of the services the pool intends to provide, particularly over the next 1–3 years, and any service level agreements in place. This will provide a clear framework against which the operational performance of the pool can be assessed.

Just as important, perhaps, is clarity on which services the pool will not provide, at least in the short term, so that officers can support these services in other ways. This could include monitoring of legacy private markets investments and fund-specific reporting on investment and carbon emissions.

Delivering well against agreed service levels will be an important first step for the pools – it will build confidence. However, in developing a framework to monitor the pool's performance, it will be essential to consider other aspects too, including pool leadership, strategy, governance, RI, investment performance and value for money. We would suggest that this broader strategic and governance monitoring is carried out at a joint shareholder committee level (acting on behalf of all partner funds). This could assess how the pool is performing not only on a standalone basis, but also relative to other pools.

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### Your checklist of immediate actions

- ◆ Engage with your pool to understand plans and the timetable for the delivery of services
- ◆ Agree service levels from the pool and regular reporting as part of an operational monitoring framework
- ◆ Identify resourcing to deliver services not being provided by the pool
- ◆ Investigate options for pool monitoring at a broader strategy and governance perspective

## What wider governance support can funds call upon?

The 'Fit for the Future' changes build on the Scheme Advisory Board's Good Governance project (from 2019–2021) to create additional governance controls. This includes the newly created role of senior LGPS officer, which involves developing the fund's governance administration and training strategy. In addition, the fund will be subject to an independent governance review once every three years, which will assess how it's being run and outline any areas for improvement.

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### Your checklist of immediate actions

- ◆ Monitor developments within Pension Schemes Bill

## In summary

However you view the 'Fit for the Future' changes, there's no question that a lot needs to be done in a short period of time. Much of this activity will be undertaken by the pools, to make sure they're set up to deliver the services expected of them – but accountability for the fund's investment strategy remains with the pensions committee. Therefore, it's important to understand how your investments will be governed in future. Working through the actions discussed above will provide a foundation for your future investment governance arrangements.

## Contact us

**To find out more about the ideas discussed in this article, don't hesitate to get in touch with the author of this article or Iain Campbell.**

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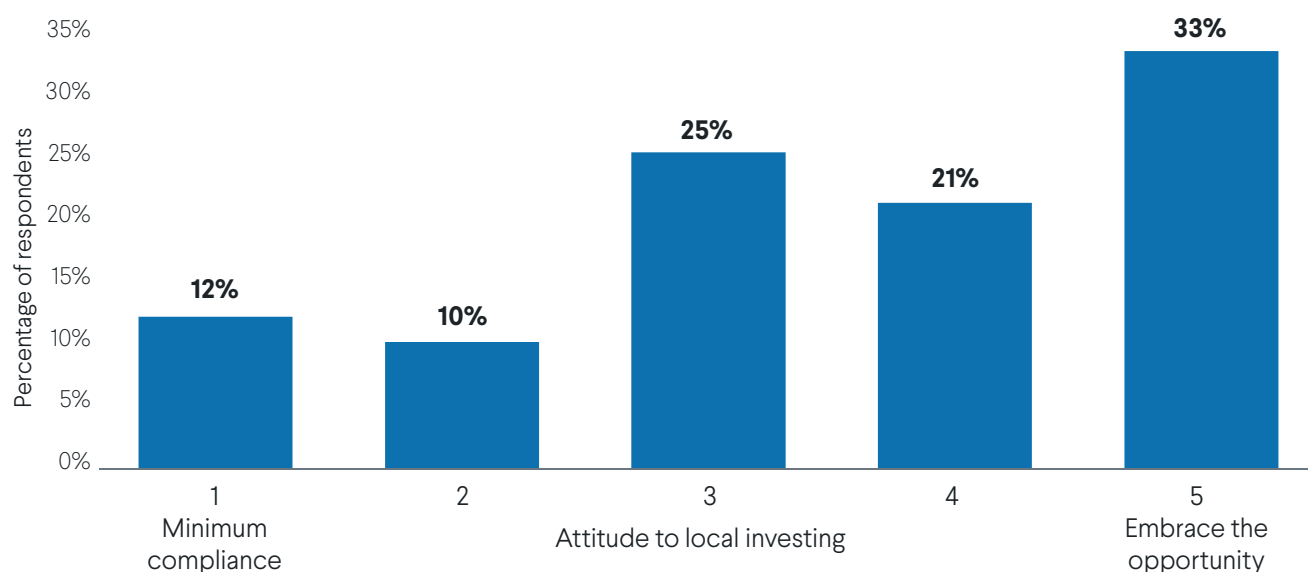
# Local investing in 2026: turning strategy into action

For funds and pools alike, 2026 is a momentous year. The deadlines set out in the 'Fit for the Future' consultation are fast approaching, bringing big changes to pooling (discussed on page 10) and stipulations for how funds approach local investing. Firstly, funds in England and Wales are required to document their approach to local investment and set a strategy with a target range (for example, 3–7%). Their approach must be written into their Investment Strategy Statement (ISS). Funds must also work with their strategic authority or local authority to identify suitable local investment opportunities, and later to report on the extent and impact of their investments. While these requirements are incumbent on English and Welsh funds, Scottish funds are also showing increased interest in how they can invest locally.

In the second half of 2025, we surveyed senior officers of 24 funds to gauge how prepared they felt to meet these challenges. We found that a minority of funds in our survey (35%) have a documented local investing strategy in place. The majority do not.

More broadly, our survey found that opinions among LGPS stakeholders were very mixed. Some funds are enthusiastic and want to embrace this opportunity to support the local area. Many are cautious about the practical implementation challenges and are worried that pools may not be ready in time. Wherever your own fund sits on this spectrum, there are some clear steps you can take as the clock ticks down to the deadline. When advising our LGPS clients, we've used the following blueprint to identify and plug knowledge gaps, and to help stakeholders articulate their plans in the ISS.

**Question: On a scale of 1 ('minimum compliance') to 5 ('embrace the opportunity'), what is your attitude to local investing?**



Totals may not add up to 100% because of rounding.

Source: 2025 Hymans Robertson Local investment in the LGPS: fund survey

## Getting ready: our three-step process

### 1. Fill any knowledge gaps

Training helps decision-makers identify any gaps in your current approach. Your training should cover the following:

- ▶ A recap of the government's position, together with some historical context.
- ▶ Discussion of the practicalities:
  - Outline what local investments tend to look like, to help ground discussions in a realistic understanding.
  - The government expects partner funds to collaborate with local/strategic authorities. The LGPS sector hasn't formed a consensus on what this looks like yet, but your training should help you explore the possibilities.
  - How might partner funds work with pools?
  - How have early adopters of local investing solved these problems, and how might their context differ from yours?

At its best, the training also creates a forum to review and discuss the key elements of the local investing strategy, leaving committee members well positioned to form views that can enable good decision-making.

### 2. Reach a consensus on what 'local' means for your fund

Ultimately, the local investing strategy should be based on the opinions and preferences regarding local investing strategies of the fund's key stakeholders. A natural way to bring these views together is by using a tailored survey for committee members that captures the appropriate considerations. Its questions cover fiduciary considerations, member attitudes, ambition levels, impact goals, geographic scope, asset classes and risk-return expectations.

Our approach gauges a fund's ambition level for local investing, categorised as high (likely targeting local private markets investments >5%), medium (likely a range around 5%) or low ambition. This, in turn, influences both target proportions and the speed of implementation. Definitions of 'local' vary from a fund's administering authority area or the broader pool authority areas. Asset class and implementation considerations are included too. The survey explores a fund's preferences for local investments to be primary private market investments only or include public market investments, or specific asset classes such as housing, noting that primary private investments typically have greater impact.

Lastly, the survey seeks to understand whether most scheme members would feel neutral, positive or opposed to local investments. This is a pragmatic way of implementing what some consider to be a fiduciary duty to consider member interests. We send the survey to committee members to gather a range of views, which are then aggregated to inform the strategy.

It's also possible to change the order of events (survey first and training afterwards); doing the survey first means that stakeholders join the training having already considered the key questions, making it easier to reach consensus. On the other hand, doing the training first means respondents are better informed when filling in the survey.

### 3. Writing your local impact strategy

At this stage, you'll have documented clear beliefs around local investment, including desired outcomes and risk appetite. The training stage will have augmented your understanding of the risks and opportunities, given you some ideas about implementation, and helped you reach a consensus.

The government has indicated that you should set out your local investment strategy in your ISS. But it hasn't stipulated exactly what the strategy should include, other than setting out what you're trying to achieve, including your target range for how much you're investing locally.

Your consultant can support you with the content, which will largely mirror the beliefs that you've clarified through the earlier steps in the process – especially your target range and your definition of local. In addition, you should outline how you'll monitor and report on your local investments over time.

Best practice would be to have this all done and ready to share with your pool by 31 March 2026. This means that your pool can meet your needs. Communicating your needs when your working relationship with the pool begins helps you be a better collaboration partner. For some partner funds, it may be challenging to conduct all three steps by that deadline. If that's the case for you, we recommend a discussion with your consultant so that you can find the best, most pragmatic way forward.

## Summing up

2026 marks a pivotal year for local investing, as funds move the dial from ideation to implementation. By acting now to define and articulate your fund's approach, you can ensure your strategy is proactive – rather than simply adopting solutions shaped by others. As the deadline approaches, collaboration between partner funds and pools will be essential to balance diverse views and deliver effective local investment solutions at scale. Meanwhile, oversight and strategic guidance will be crucial as pools work at pace to meet these new requirements.

**If you'd like to discuss any of the themes outlined in this article or need support in shaping your fund's local investment strategy, please don't hesitate to contact your usual Hymans Robertson consultant or the author of this article. Our team has extensive experience advising on local investing, pool oversight, responsible investment and governance, and we're here to help you turn ideas into action.**



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# Pool oversight – what you need to know

The government's 'Fit for the Future' consultation has fundamentally changed the way in which local authority pension assets will be managed, for both funds and pools. From **1 April 2026**, pools will be responsible for providing strategic investment advice and its implementation across all assets. They will have a significant influence on your investment outcomes – risk and return, responsible investment, cash flow generation and local investment, to name just a few. Ultimately, pools will have a much more significant role, acting on behalf of investors (funds and committees) and owners (shareholders).

In this article, we set out some of the key considerations for both funds and pools in the coming months, and explain the role we can play to assist you.

## A breakdown of responsibilities – who does what?

	Task	Impact on overall investment outcome of the Fund	Administering authority role	Pool role	Definitions
Strategy	Investment objectives	High   Low	Decide	Advise	Return objectives, risk tolerances, investment preferences, constraints and limitations, and the approaches to local investment and responsible investment.
	Strategic asset allocation		Decide or Monitor	Advise or Decide	Long-term, stable allocation based on overall investment objectives and risk tolerance.
Implementation	Tactical asset allocation		Monitor	Decide	Adjustments to the asset mix, such as in respect of geographic allocation, consistent with the asset allocation strategy.
	Investment manager selection		Monitor	Decide	Appointment of external (or in-house) managers of specific investment mandates.
	Stock selection		Monitor	Decide	Choosing individual investment opportunities based on detailed analysis of the opportunity.
	Investment stewardship		Monitor	Decide	Engagement with the invested companies in line with Investment Objectives.
	Cash flow management		Monitor	Decide	Management of the disinvestment (or investment of contributions) in collaboration with administrators and Fund Actuary.

Source: Local Government Pension Scheme (England and Wales): Fit for the future, <https://www.gov.uk/government/consultations/local-government-pension-scheme-england-and-wales-fit-for-the-future/>

## How we can help: your trusted partner through this transition

As an industry-leading adviser to UK public sector pension schemes, we're well positioned to deliver comprehensive oversight for LGPS pools. We understand the LGPS and pooling, what is important to funds, and how to communicate this in understandable and actionable ways. Our services will provide clarity, accountability and independent assurance to pension committees, scheme members and other stakeholders.

We also provide fiduciary oversight services to multi-billion-pound private sector schemes, to ensure their fiduciary/OCIO arrangements are operating as efficiently as possible. We know the key questions to ask when a scheme transitions to these arrangements, and we're well versed in constructively highlighting gaps or concerns. Our pool oversight services combine all of these qualities, giving funds confidence in the new regime, while helping pools harness best practice and the leading initiatives from funds.

## Your next steps

Given that there are a lot of moving parts to consider, we suggest that funds and pools take an incremental approach to meeting the 1 April deadline, identifying and prioritising key actions. Here are some of the key things we'd expect funds and pools to focus on, along with the support we can provide to help you transition smoothly to the new regime.

- **Day 1 due diligence:** before passing the reins over to pools for all aspects of advice and implementation, funds have a fiduciary responsibility to ensure they're comfortable that their pool can meet the required standards. To assist you, we'll harness our existing pool research, tailored to fund/shareholder requirements, to give you confidence that what has been built is indeed fit for the future across all aspects of advice, implementation and operational resilience.
- **Ongoing pool due diligence:** we suggest reviewing arrangements in 2026 or 2027 and then every 3–5 years thereafter (or more frequently if there is a catalyst). These detailed reviews would cover the pool's approach to strategic matters, staffing, philosophy, client service, risk management, operational aspects and new investment products. This work is essential for maintaining quality service to funds and shareholders in the long term.
- **Quarterly monitoring:** Hymans receives quarterly updates from all pools, and we hold periodic calls to discuss new developments and how key services are delivered. For some of our clients, we already provide quarterly reporting covering these topics; these findings can complement the fund's monitoring. Establishing KPIs for key areas such as risk management, implementation activity, transparency and client service would provide a clear gauge of progress. The monitoring service will support pools and funds to oversee activity and keep tabs on developments.
- **Securing an independent view:** as a fiduciary manager, pools will be responsible for advice and implementation services. Where funds receive advice, Hymans is ideally placed through our own experience and expertise to ensure it is suitably tailored and robust, covering key investment matters, eg changes to investment strategy and/or fiduciary guidelines.
- **Reviewing performance:** in-depth reviews of sub-funds can be used to assess key performance drivers (dynamic allocation, stock selection, etc), benchmark fees and risk management. This information will support shareholder understanding of the key factors shaping performance, and equip funds with the data and knowledge to challenge the pool.
- **Strengthening governance:** pool governance is an important aspect of success, spanning reviewing risk registers and policies. A governance review would examine the terms upon which the pool makes decisions and includes funds. We can create and monitor an RACI model for the fund, fund collective and pool, to review the effectiveness of decision-making in governance matters.
- **Onboarding oversight (for funds moving pool):** our team has extensive experience of clients moving from consulting to fiduciary arrangements. This will be particularly relevant for funds that are moving to new pools. We can review initial and ongoing onboarding programme plans, the governance structure, the risk register and provide project-management support on the fund's behalf (managing actions/decision-making processes on the fund side and feeding into the overall pool plan).

## Immediate actions to meet the 1 April deadline

- ◆ Day 1 due diligence
- ◆ Strengthening governance
- ◆ Onboarding oversight

## April 2026 and beyond

- ◆ Ongoing pool due diligence
- ◆ Quarterly monitoring
- ◆ Securing an independent view
- ◆ Reviewing performance
- ◆ Strong governance

## Contacting us

**We see our role as supporting the positive evolution of the pool and partner funds to create best-in-class investment and operating solutions. To find out more, please reach out to our dedicated pool oversight team.**

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# What do you do when your investment strategy is performing strongly?

As the deadline for finalising the 2025 England and Wales actuarial valuation approaches, LGPS funds must review and evolve investment strategies to maintain strong funding positions and achieve optimal outcomes for members. With improved funding levels across the LGPS industry, there is a renewed focus on integrating resilience into strategic asset allocations and adopting robust risk management practices.

## Diversification is still the only free lunch

A reasonable central outlook for medium-term market returns, as outlined in our Market Outlook, can guide a strategy. However, investors must remain prepared for the uncertainty inherent in any base case.

Echoing Harry Markowitz's maxim that "diversification is the only free lunch" in finance, we see diversification as the first line of defence against negative growth shocks and inflation risks – a combination that is particularly harmful for typical LGPS schemes. In essence, adding uncorrelated assets to a portfolio improves risk-adjusted returns by harnessing diversification benefits. As shown in Table 1 below, a diversified portfolio has historically delivered higher risk-adjusted returns while reducing drawdowns – the largest peak-to-trough decline experienced by a portfolio.

Table 1: Demonstrating diversification: 31 Jan 1993 to 31 Dec 2025

Title	Equities	60% equities / 40% bonds	55% equities / 35% bonds / 10% gold
Return (% pa)	9.0	6.9	7.0
Volatility (% pa)	15.0	9.9	9.5
Return / volatility	0.60	0.69	0.74
Maximum drawdown	-55%	-36%	-32%

Source: Bloomberg

Diversifying across asset classes helps mitigate systemic risks that affect entire markets, while diversifying within asset classes reduces idiosyncratic risks that impact specific countries, sectors or companies. Diversification is multi-faceted: it not only enhances risk-adjusted returns in average conditions, but it also reduces drawdowns and shields against 'tail' events – rare, extreme scenarios with significant impact.

## The role of scenario testing

Managing a portfolio for a single upside or downside scenario is often suboptimal. Investors must also weigh the long-term opportunity cost of diversification: all diversifiers in isolation are expected to deliver lower returns than equities, so striking the right balance between risk-adjusted and absolute returns is essential. Scenario testing helps identify portfolio vulnerabilities under different conditions and uncover untapped diversification opportunities.

Growth shocks – positive or negative – may be inflationary or disinflationary, depending on whether they stem from demand or supply factors. Portfolios should therefore protect against downside risks in both inflationary and disinflationary downturns, while capturing upside in either inflationary or disinflationary growth scenarios. As shown in Table 2, different assets are expected to outperform or underperform across the four growth and inflation shock scenarios relative to the baseline.

Table 2: Growth and inflation shock relative to baseline and potential asset class impacts

Shock relative to baseline			
Scenario	Growth	Inflation	Illustrative asset class impacts
<b>Productivity boom</b>	+	-	Growth assets outperform Credit outperforms government bonds – nominal bonds outperform linkers Long-duration and fixed-rate bonds outperform short-duration and floating-rate bonds Rising real rates and weaker haven appeal weighs on gold
<b>Unstable expansion</b>			Growth and real assets outperform Credit outperforms government bonds – linkers outperform nominal bonds Short-duration and floating-rate bonds outperform long-duration and fixed-rate bonds Lower real rates supportive for gold, but potentially offset by weaker haven appeal
<b>Stagflation</b>	-	+	Real assets outperform Linkers outperform nominal bonds Short-duration and floating-rate bonds outperform long-duration and fixed-rate bonds Lower real rates and haven appeal potentially supportive for gold
<b>Stagnation</b>			Protection and income assets outperform Nominal bonds outperform linkers – government bonds outperform credit Long-duration and fixed-rate bonds outperform short-duration and floating-rate bonds Haven appeal and lower real rates amid central bank easing supportive for gold

Source: Hymans Robertson

As the table shows, true all-weather portfolios rely on diversification. Scenario testing remains valuable for spotting vulnerabilities and uncovering untapped diversification opportunities.

These scenarios are far from abstract. Many economists believe we are entering a productivity revolution, driven by AI, that could boost growth and reduce inflation. Others warn that prolonged equity market momentum and rising valuations heighten the risk of sharp corrections if AI disappoints – particularly in the US, where equity holdings in household wealth are at record highs. In a tech-sector downturn, traditional safe havens like sovereign bonds should perform well.

Meanwhile, although modest disinflation and monetary easing remain the base case, the US faces a large fiscal deficit alongside solid growth. Fiscal stimulus combined with easing could reignite inflation; if central banks resumed rate hikes, risk markets would suffer. This scenario would also hurt nominal bonds, making inflation-linked bonds and real assets likely outperformers.

## Areas grabbing the headlines

It takes high conviction and a long-term investment horizon to fully commit to, and get the benefit of, 'free lunch' diversification. In the next section, we briefly cover some of the asset classes that are catching the headlines and give our take on what they bring to the table.

### Gilts/index-linked bonds

Government spending, inflation volatility and weaker institutional demand could keep yields high or push them higher. Nonetheless, the upshot of this is that it supports attractive income returns, while bonds continue to act as a buffer in periods of weak growth or risk-off markets.

High-quality sovereign bonds typically outperform during economic downturns as central banks cut rates and investors seek safe-haven assets. Nominal bonds tend to do best when growth slows and inflation expectations fall. Meanwhile, inflation-linked bonds outperform in stagflation, where growth is weak but inflation rises.

In short, both nominal and inflation-linked bonds hedge against downside growth risks. Nominal bonds excel when inflation expectations drop alongside growth, whereas inflation-linked bonds shine when inflation rises despite weak growth.

### Gold

A modest allocation to gold has historically improved risk-adjusted returns through diversification, long-term real returns and tail-risk protection via its haven appeal in risk-off environments. Its scarcity and broad demand drivers – including central bank reserves – support performance during economic or geopolitical stress.

However, gold provides no yield, with returns driven solely by price movements, creating an opportunity cost in stable markets. While it shows low correlation with other assets and turns negatively correlated in risk-off periods, gold is volatile in isolation and has experienced sharp downturns. Although often cited as an inflation hedge, its short-term relationship with inflation is inconsistent. We view gold as a hedge against long-term inflation rather than a reliable short-term inflation protector.

### Equity protection

Perhaps conspicuous by its absence, we have not included equity protection in our diversifying assets, as we only see merit in its use by long-term investors in specific short-term circumstances.

Equity protection, or structured equity, uses derivatives to reshape equity market returns. Options provide the right, but not the obligation, to buy or sell shares at a set price on a future date. While solutions vary, the goal is to maintain equity exposure while managing risk.

Protection against market downturns is common, but it comes with uncertainty and an upfront cost. This cost can be offset by capping upside beyond a certain level and accepting some tail risk.

For LGPS funds with long-term horizons and access to alternative risk premia, structured equity should be used only in specific short-term scenarios. One example is during transitions from public to private markets, where commitments take time to draw down. Overlaying equity protection can help manage exposure during this period.

With perfect foresight, structured equity could improve outcomes in stressed markets, but in almost all benign conditions, it will be a drag on returns. Therefore, we see equity protection as a tactical, event-driven tool for LGPS funds – not a permanent feature of long-term strategic allocations.





## Summary

With LGPS funds now in a strong funding position, robust risk management is essential. A clear plan for managing risk in both normal and stressed market conditions is a good starting point. Flexibility and access to a broad range of options can help navigate uncertainty and support a smoother funding journey.

Maintaining diversification and stress-testing strategies across different growth and inflation scenarios will highlight portfolio vulnerabilities and opportunities to strengthen resilience. This approach enables LGPS funds to stay on track towards their ultimate objectives.

## Contact us

**If you'd like to discuss our market views in the context of your LGPS portfolio, please don't hesitate to contact the author or your usual Hymans Robertson consultant. If you'd like to discuss our views on anti-fragile assets, please don't hesitate to contact Elaine or your usual Hymans Robertson consultant.**



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## A note about derivatives

All forms of derivatives can provide significant benefits, but may involve a variety of significant risks. Derivatives, both exchange-traded and OTC, include options, forwards, swaps, swaptions, contracts for difference, caps, floors, collars, combinations and variations of such transactions, and other contractual arrangements (including warrants), which may involve, or be based upon, one or more of the following: interest rates, currencies, securities, commodities and other underlying interests.

The specific risks presented by a particular derivative transaction depends on the terms of that transaction and your circumstances. It is important you understand the nature of these risks before entering into a derivative contract.

In general, however, all derivatives involve risk, including (among others) the risk of adverse or unanticipated developments of a market, financial or political nature, or risk of counter-party default. In addition, you may be subject to operational risks in the event that your manager(s) does not have in place appropriate legal documentation or internal systems and controls to monitor exposures of this nature.

In particular, we draw your attention to the following:

- Small changes in the price of the underlying security can lead to a disproportionately large movement, unfavourable or favourable, in the price of the derivative.
- Losses could exceed the amount invested. There may be a total loss of money/premium. Further, an investor may be called on to make substantial additional payments at short notice. Failure to do so in the time required can result in additional loss.
- The right to subscribe is invariably time limited; if such a right is not exercised within the pre-determined timescale, the derivative may be rendered worthless.
- Not all derivatives are liquid (ie, they may be difficult or, at times, impossible to value or sell). You may incur substantial costs if you wish to close out your position. OTC derivatives in particular can introduce significant liquidity risk and other risk factors of a complex character.
- OTC derivatives may result in exposure to the creditworthiness of the derivative counter-party.
- Derivatives used as part of 'protection' strategies may still expose the investor to an unavoidable difference between the underlying asset (or other interest) and the protection offered by the derivative.

# Market outlook

## 2025 highlights

- ◆ Global growth has held up remarkably well in 2025, despite sharply higher tariffs imposed by the US and economic uncertainty. Companies got ahead of the tariffs by 'front-loading' orders in advance, while strong business investment in the US also supported growth.
- ◆ Economists' forecasts put global growth at 2.6% in 2025 and only modestly lower, at 2.5%, in 2026.
- ◆ The short-term outlook for the global economy looks relatively robust.
- ◆ The AI-driven investment boom in the US, the delayed impact of interest-rate cuts and healthy corporate finances are underpinning this positive outlook.
- ◆ US and European policymakers are also adopting supportive fiscal policies, with the promise of more to come in Japan.
- ◆ For longer-term investors, such as the LGPS, it's important to look past short-term market noise to focus on longer-term strategic objectives and the assets most likely to achieve them.
- ◆ In the medium term, we're cautious on 'risk' markets. This is mainly because equity and credit markets both look expensive relative to historical norms and our estimates of fair value.

## Central banks and interest rates – where to from here?

### Three US rate cuts expected in 2026

Amid evidence that the US labour market is cooling, but not collapsing, the US Federal Reserve (Fed) is expected to heavily prioritise the employment side of its mandate while looking through current, and forecast, above-target inflation. US interest-rate futures are pricing at least one more 0.25% pa rate cut this year, followed by three more in 2026. If realised, this would leave the Fed Funds rate at 3.0% pa by the end of 2026. The Fed may find it difficult to justify the extent of interest-rate cuts implied by the market unless growth and inflation slow more dramatically than is currently forecast.

### A slow approach to cutting interest rates from the Bank of England (BoE)

Given persistence in underlying inflation pressures and a bank rate that the BoE thinks is only modestly restrictive, further moves from the central bank are expected to be more cautious. Nonetheless, with the unemployment rate rising to a post-pandemic high of 5.1%, supporting suggestions of further moderation in wage growth, markets expect a cut in December, followed by at least one more in 2026, which would leave the BoE's base rate at 3.5% pa.

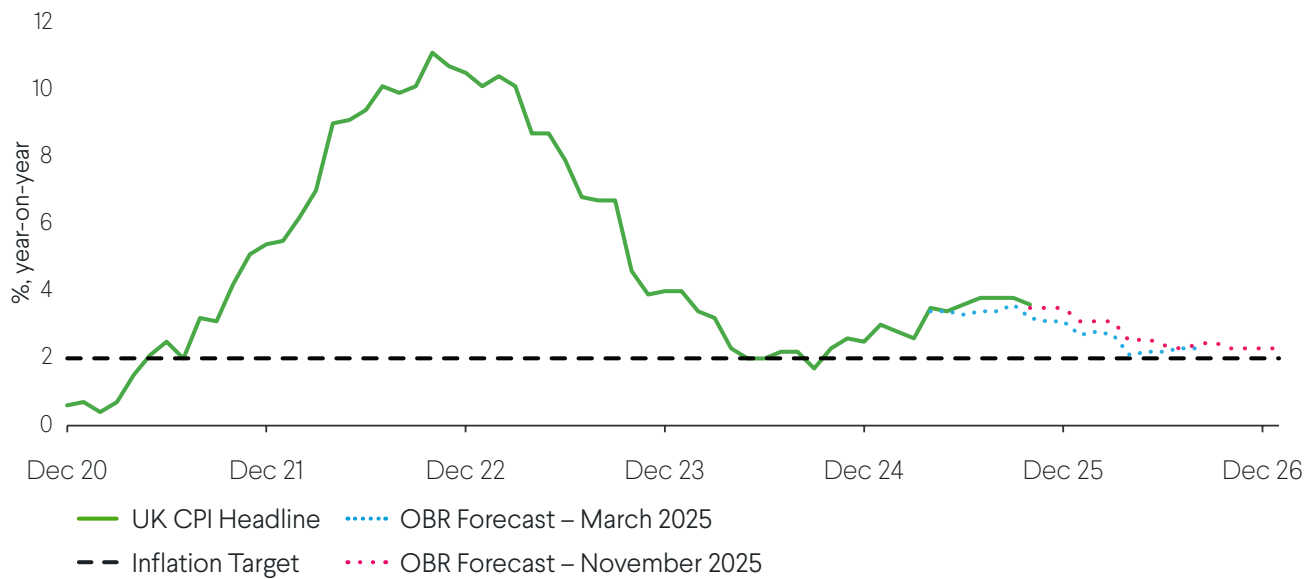
## Our views on inflation

After peaking at 3.8% in September, annual UK CPI eased to 3.6% in October, driven by lower energy and house prices. Core inflation fell to 3.4% and is now below headline CPI. We expect inflation to continue to moderate; cuts to green levies announced in the budget will temporarily push inflation sharply lower in 2026. However, there is still some persistence in underlying inflation pressures. The BoE Decision Maker Panel's suggestion that wage settlements will average 3.5% over the next 12 months (set against the OBR's subdued productivity forecast of 1% pa) remains consistent with slightly above-target inflation.

On a longer-term view, we think central banks will mostly stick to their inflation goals. But changes in the job market, more active government spending, and risks from global tensions and climate change mean inflation is likely to be less stable. Overall, there's a higher chance that inflation will be slightly above central-bank targets rather than below them.

Likewise, we expect real and nominal rates to more closely align with real and nominal growth, respectively, than in the period after the 2008 global financial crisis.

#### Inflation in the UK and US is expected to stay above target until at least 2027



Sources: Bloomberg and Office for Budget Responsibility (OBR).

## High-level asset-class views

### Equities

Cyclically adjusted global equity valuations have risen in 2025 and are high relative to history. Moreover, materially positive real yields mean the excess earnings yield, which can be interpreted as an 'equity risk premium', looks very low. This indicates that equity risk does not currently look particularly well rewarded. We note that the US is primarily responsible for this apparent expensiveness, making us particularly cautious on the medium-term outlook for US equities.

#### Ten-year expected global equity returns, % pa\*

	Assuming reversion in earnings and valuations		No reversion in earnings and valuations	
	31 Dec 2024	28 Nov 2025	31 Dec 2024	28 Nov 2025
Dividend income	2.1	1.6	1.7	1.6
Trend earnings growth	2.3	2.3	2.3	2.3
Reversion to trend earnings	-0.6	-1.1	0.0	0.0
Revaluation	-1.9	-2.1	0.0	0.0
Real return	1.9	1.1	4.0	3.9
Nominal return <sup>1</sup>	4.1	3.5	6.2	6.2

<sup>1</sup>Consensus forecast for 10-year average US CPI inflation = 2.3% pa.



## Credit

Investment-grade credit spreads at current levels are cause for caution for investors with short time horizons; however, they still provide a premium over long-term average expected default and loss. Furthermore, given attractive underlying sovereign bond yields, the medium-term total return potential from corporate bonds looks reasonable. We are more cautious on speculative-grade credit, where the risk of actual credit loss is greater.

Ten-year expected global equity returns, % pa\*

10-year expected returns, % pa	31 December 2024		28 November 2025	
	Sterling investment grade	US high yield	Sterling investment grade	US high yield
Initial spread	0.9	2.9	0.8	2.9
Neutral spread	1.5	4.4	1.5	4.2
Average spread	1.2	3.6	1.2	3.6
Revaluation	-0.4	-0.6	-0.4	-0.5
Credit losses	-0.2	-2.0	-0.2	-1.9
Excess return	0.6	1.1	0.5	1.2
Risk free return <sup>2</sup>	5.7	4.3	4.7	3.8
Nominal return	6.3	5.4	5.3	5.0

<sup>2</sup>Ten-year gilt return for investment grade, five-year gilt return for high yield, and cash return for loans.

## Sovereign bonds

Despite a challenging technical backdrop of heavy bond issuance and lower demand from institutional buyers, we find attraction in sovereign bond yields, which look high relative to long-term growth and inflation forecasts. Downgrades to real UK growth forecasts (alongside upgrades to inflation forecasts) and a cheapening of implied inflation have improved the relative attraction of index-linked gilts in 2025.

Ten-year expected global equity returns, % pa\*

10-year expected returns, % pa	31 December 2024		28 November 2025	
	Index-linked gilts	Nominal gilts	Index-linked gilts	Nominal gilts
10-year spot yield	1.1	4.7	1.6	4.6
10/10 forward yield	2.4	5.9	2.7	6.1
Neutral 10/10 forward	1.3	3.8	1.3	3.8
Yield uplift	-0.6	-1.1	-0.7	-1.1
Capital gain/loss	1.2	2.1	1.4	1.7
Real return	1.7		2.2	
Inflation <sup>3</sup>	2.5		2.8	
Nominal return	4.2	5.7	5.0	5.3

<sup>2</sup>Ten-year gilt return for investment grade, five-year gilt return for high yield, and cash return for loans.

## Currency

Given the US dollar's year-to-date weakness, sterling now looks fairly valued versus the dollar, based on the real effective dollar/sterling exchange rate relative to its long-term trend. However, increased hedging of dollar exposure by global investors, which has largely been responsible for dollar weakness in 2025, may itself continue to weigh on the currency in the near term. Furthermore, questions over the dollar's safe-haven status and a very negative net international investment position may lead investors to reconsider strategic hedge levels.

### \*Asset-class considerations

The deterministic returns shown above are fundamental, or structural, in nature. They are central expectations of returns from asset classes derived from income, and changes in income and prices. These are prepared separately from our Economic Scenario Service (ESS), which generates returns in a fundamentally different way. All ESS returns are essentially a combination of risk-free rate, or cash, plus a risk premium, arrived at via stochastic simulations based on key inputs and variables determined by their underlying statistical distributions.

## Taking a long-term view

Our medium-term caution on risk markets stems less from near-term fundamentals and more from high valuations. Both equity and credit markets appear expensive relative to historical norms and fair value estimates based on long-term earnings and loss assumptions.

High global equity valuations are largely driven by the tech-heavy US market. While strong tech earnings justify some premium, valuations assume sustained growth and leave the US exposed to AI disappointment. Even with a lasting premium, the US appears fully valued – supporting the case for regional diversification beyond that provided by US-dominated, global market-cap-weighted indices.

## Contact us

**If you'd like to discuss our market views in the context of your LGPS portfolio, please don't hesitate to contact the author or your usual Hymans Robertson consultant.**



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## General investment risk warning

Please note the value of investments, and income from them, may fall as well as rise. This includes but is not limited to equities, government or corporate bonds, derivatives and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of investments. As a result, an investor may not get back the full amount of the original investment. Past performance is not necessarily a guide to future performance.



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