



Investment Update January 2012

Investment Headlines & Comment

- **Aviva** has plans to scale back its corporate governance and socially responsible investment operations.
- **Greek** 5-year yields are now at over 50% pa, and **Portugal's** have gone above 20% pa.
- However, most risk-based assets rallied this month, with Emerging Markets in the lead (see page 2).

Feature Section

This month, having previously looked at Forestry in our June 2011 edition, we consider another rather unusual Commodities investment. Guest contributor, Andrew Davison (Director of The Vintage Wine Fund), outlines the history and practicalities of investing in vintage wine. Data is sourced from Liv-ex, the London International Vintners Exchange, the main source of fine wine market information.

Figure 1a shows that prior to the second half of the 1990s, large sudden movements were fairly uncommon. However, in the last 15 years there have been 3 major squeezes up in price followed by corrections. In each case it has been a different group which has driven the rally: in the 1990s, a small number of wealthy Asian speculators; in 2005 to 2007, the very large (often leveraged) inflows of capital from professional investors; in the late 2000s, mainland Chinese buyers mesmerised by the famous Bordeaux brands. However one important influence in all three episodes has been that of the producers themselves and the setting of prices for new vintage releases – known as the *en primeur* campaign.

Figure 1a: Fine Wines Investables Index

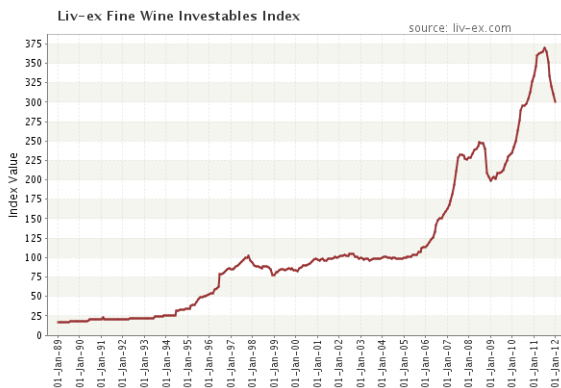
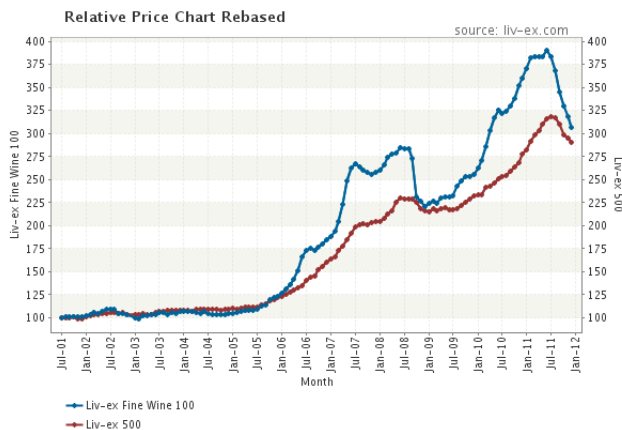


Figure 1b: The Fine Wine 100 effect



Each year in spring/early summer the chateaux release for sale a proportion of their new vintage while it is still maturing in barrel some two years prior to bottling. In the past, prices were cheap since the wine was still very immature (and so somewhat unpredictable as to final quality) and attractive prices were also necessary to shift the entire crop, which is what was generally desired so as to free up capital. Prices varied only slightly from year to year, so when there was a great vintage (e.g. 1982, 1990), buying *en primeur* could yield large profits and, even in the off vintages, breaking even was about as bad as it got.

Things started to heat up again with some pretty serious speculative capital through formally structured investment funds in the first half of the 2000s. These had a need for regular valuations and this naturally led them to focus on classed growth Bordeaux – the most liquid part of the market with the highest price transparency. The money flowed in and first growth claret began to dramatically outperform the wider market, as per Figure 1b – a pattern seen again during the “Chinese” rally a few years later. (Ed.: The Fine Wine 100 is for the most sought-after 100 wines, whereas the “500” index is the broadest based index – a bit like the FTSE100 and All Share indices for UK Equities.)

The chateaux were once again emboldened to hike release prices (especially the 2005 vintage) and it all began to feed on itself. High release prices meant investors snapped up relative bargains in older vintages pushing those prices higher and giving the producers more ammunition to justify ever-higher *en primeur* prices.

But this influx of professional money, particularly the cash flowing from hedge funds of funds into the wine funds, created a tighter link between the wine market and the wider financial system than had ever before existed. When things started to go wrong and sub-prime raised its ugly head, losses incurred by the funds of funds in the credit markets triggered redemptions by their customers and that meant the liquidation of all their underlying holdings – including the wine funds. So, as the financial markets descended into disarray, the wine market followed suit. The oft-quoted claim that wine was weakly correlated to financial markets and a good diversification tool suddenly looked rather lame. Next month Andrew concludes the recent history and highlights several aspects which a would-be investor must take into account.



Asset Returns and Financial Measures [in Sterling unless marked otherwise]

The cells in bold with light shading show the best and worst performing asset classes from each column. The commodities and \$-based and unhedged-£-conversion hedge fund returns are excluded from that.

[NB Future returns cannot be inferred from this table alone, but coupled with other items within *Update*, readers can make inferences as to whether they should be higher or lower than the past returns shown below.]

Table 1: Investment Data to 31 January 2012

Asset Class	1 month (%)	3 months (%)	12 months (%)	3 years (% p.a.)	5 years (% p.a.)	10 years (% p.a.)	20 years (% p.a.)
UK Equities	2.7	3.2	-0.3	16.2	1.8	5.2	8.1
Overseas Equities	4.6	5.0	-1.9	14.8	4.3	4.7	7.6
US Equities	3.2	7.8	5.7	15.8	5.0	2.6	8.7
Europe ex UK Equities	4.6	-0.3	-13.4	10.2	-0.3	5.3	8.8
Japan Equities	2.9	3.1	-8.4	2.7	-1.6	3.3	0.7
Pacific ex Japan Equities	8.7	4.0	-4.0	24.5	10.5	12.2	9.4
Emerging Markets	9.7	5.0	-4.9	23.8	9.9	13.8	8.9
UK Long-dated Gilts	0.7	7.4	32.1	13.3	9.5	7.2	9.4
UK Long-dated Corp. Bonds	2.2	3.8	16.3	14.1	6.1	6.0	-
UK Over 5 Yrs Index-Linked Gilts	0.5	10.5	27.2	13.2	10.3	8.5	8.5
High Yield (Global)	2.3	4.8	5.5	19.7	12.4	8.1	-
Overseas Bonds	-0.3	3.4	9.7	3.5	13.2	7.1	7.4
Property *	0.5	1.6	8.1	8.1	-1.5	6.6	8.4
Cash	0.1	0.3	0.9	0.9	2.8	3.6	5.1
Commodities £-converted	0.7	3.8	-0.5	7.8	2.5	5.0	4.5
Hedge Funds original \$ basis *	-0.4	1.0	-5.1	7.9	2.3	5.9	10.6
Illustrative £-converted version *	0.8	1.2	-4.4	5.6	7.1	5.2	11.6
Euro relative to Sterling	-0.7	-4.0	-3.1	-2.3	4.6	3.2	-
US \$ relative to Sterling	-1.5	2.3	1.5	-3.0	4.5	-1.1	0.6
Japanese Yen relative to Sterling	-0.6	4.7	9.1	2.5	14.5	4.6	3.2
Price Inflation (RPI) *	0.4	0.6	4.8	4.0	3.4	3.3	2.9
Price Inflation (CPI) *	0.4	0.7	4.2	3.6	3.2	2.5	2.2
Price Inflation (RPIX) *	0.4	0.6	5.0	4.5	3.9	3.3	3.0
Earnings Inflation **	0.1	0.3	2.0	1.6	2.5	3.2	3.5
All Share Capital Growth	2.6	2.5	-3.7	12.2	-1.8	1.6	4.4
Net Dividend Growth	-2.0	3.1	11.2	-0.4	1.6	4.1	-
Earnings Growth	0.0	-0.3	13.3	4.2	3.6	8.5	-

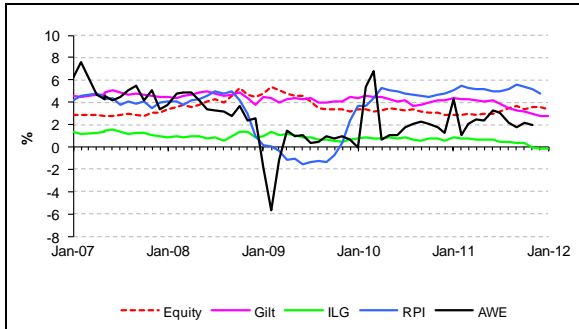
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- UK Equities (incl. dividends and earnings) – FT-A All Share.
- Overseas Equities (incl. regions) – blend of FT All-World / World subindices
- Emerging Markets from MSCI US \$ based total return index (overall Index to 31 Oct 2001, Free Index from 1 Nov 2001 to take account of foreign investment restrictions), conversion to UK £ by J&A.
- UK Bonds – FT-A indices (Gilts Over 15 Years, ILG Over 5 Years)
- UK Corporate Bonds – iBoxx Non-Gilt **Over 15 Year** index (all credit ratings combined)
- High Yield – Merrill Lynch Global, £ Unhedged
- Overseas Bonds – JP Morgan Traded Unhedged World ex UK
- Property – IPD Monthly Index
- Commodities – GSCI Total Return, converted to UK £ by J&A
- Hedge Funds Composite – HFRI US \$ based total return index plus converted to UK £ by J&A. **NB A smooth “cash+x%” return will only be shown in the base ‘hedged’ currency, here the US \$.**
- Cash – an indicative index based on the three-month London Interbank Sterling mid-rate, calculated internally by J&A
- Price and earnings inflation – RPI, CPI, RPIX, and Average Weekly Earnings (whole economy, not seasonally adjusted, latest provisional data)
- Currency data – London close, from the Financial Times
- * denotes data lagged by 1 month, ** by 2 months – these reflect the later publication dates of these data items.

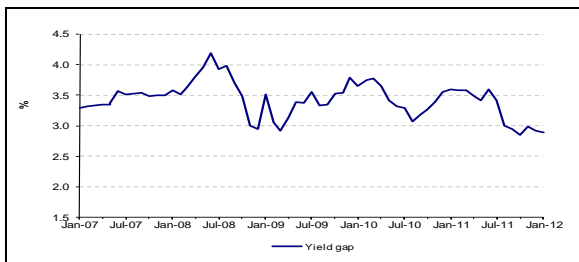


Yields and Yield Gaps

Figure 2: Yields, Inflation and Yield Gaps



The yield gap is a measure of expected average future inflation, derived as long bond yield minus ILG yield.

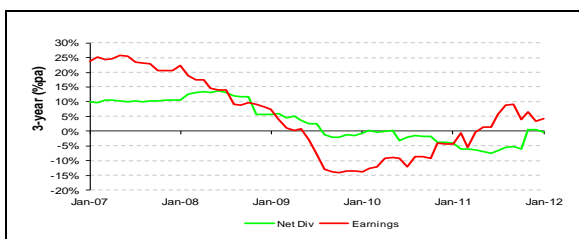
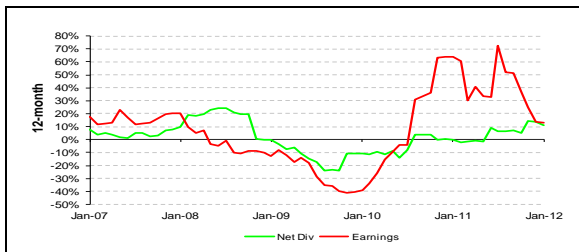


The gap gives expectations still just below 3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

Growth in Earnings and Dividends

These charts show movements in rolling 12-month and 3-year dividend and earnings growth for UK Equities over the last 5 years. [NB the charts have different scales]

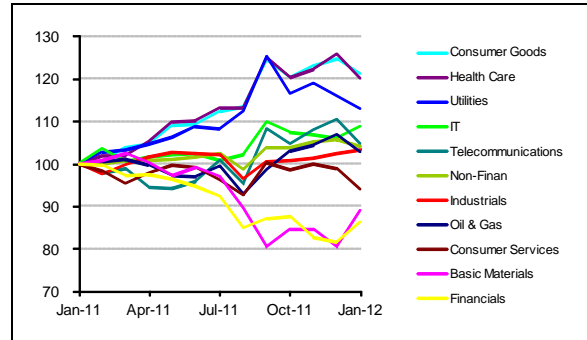
Figure 3: Dividend & Earnings Growth



Sources for charts on this page:
Financial Times, Office for National Statistics, J&A

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



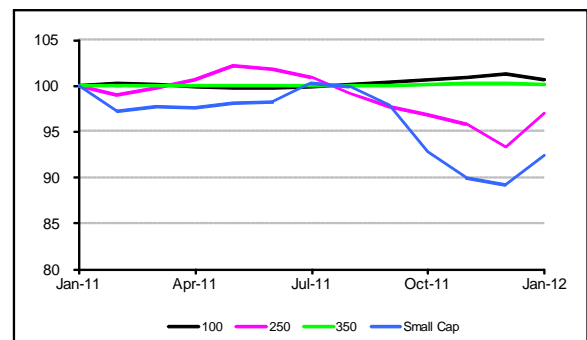
Note: Sector labels for relative lines are in end-value order

There was a sharp fall this month in the rolling 12-month sector dispersion (down from 48% to 35%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-1.2	3.1	2.5
Basic Materials	13.7	8.5	-11.3
Industrials	3.7	5.9	3.0
Consumer Goods	-0.2	4.0	20.8
Health Care	-2.0	2.9	19.6
Consumer Services	-2.6	-1.9	-6.4
Telecommunications	-2.7	3.3	4.4
Utilities	-0.1	-0.0	12.5
Non-Finan	1.3	3.7	3.9
Financials	8.6	1.5	-14.1
IT	5.4	4.5	8.6
All Share	2.7	3.2	-0.3

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Small and Mid Cap both rallied in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.

Bond market information



Figure 5: £ Non-Gilt Credit Margins

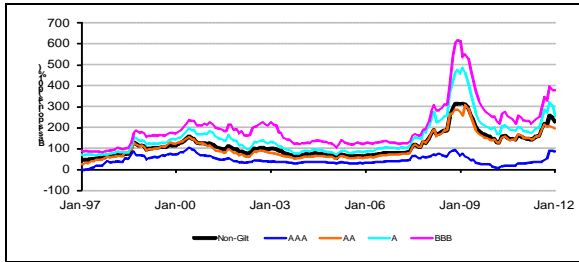


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Aug 11	5.30	3.68	1.62
Sep 11	5.06	3.25	1.81
Oct 11	4.89	3.19	1.70
Nov 11	4.81	2.95	1.86
Dec 11	4.63	2.78	1.85
Jan 12	4.55	2.75	1.80

Tables 2b, 2c: £ Market Size and Maturity

Category	Mkt Val (£bn @ Jan 12 & 09, 06)			Weight (%)
Gilts (35)	1,018	476	317	68.2
Non Gilts (996)	474	392	373	31.8
AAA (156)	123	147	142	8.2
AA (145)	67	57	58	4.5
A (362)	162	122	111	10.9
BBB (333)	123	63	58	8.2

Category	Mkt Val (£bn @ Jan 12, 09)		W't (%)	Dur'n (yrs)
Gilts (35)	1,018	476	68.2	9.8
< 5 Yrs (9)	278	136	18.7	2.8
5-15 Yrs (11)	337	157	22.6	7.1
> 15 Yrs (15)	402	183	26.9	17.1
Non Gilts (996)	474	392	31.8	7.8
< 5 Yrs (267)	123	139	8.3	2.7
5-15 Yrs (454)	203	144	13.6	7.0
> 15 Yrs (275)	148	110	10.0	13.2

Sources: Barclays Capital, DMO, iBoxx, J&A, MLX

£ Gilt Market “main” Issuance

- £4.13bn 4% 2016 (2.02x, 0.89%, prev Jul 10)
 - £4.12bn 1¾% 2017 (2.02x, 1.10%, Dec 11)
 - £3.28bn 3¾% 2021 (2.15x, 2.09%, Dec 11)
 - £4.75bn 3¾% 2052 (2.61x, 3.18%, Sep 11)
 - £0.74bn ILG ¾% 2047 (1.92x, r.y -0.12%, Sep 11)
- Note: Issuance amounts are nominals.

Tables 2d, 2e: € Market Size and Maturity (Jan 12)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (248)	4,166	57.7
Non Sovereigns	3,057	42.3
AAA (663)	1,262	17.5
AA (420)	615	8.5
A (705)	761	10.5
BBB (503)	419	5.8

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (848)	2,057	28.5
3 – 5 Yrs (695)	1,662	23.0
5 – 7 Yrs (397)	947	13.1
7 – 10 Yrs (391)	1,339	18.5
10+ Yrs (208)	1,218	16.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jan 12 & 09)		W't (%)	Dur'n (yrs)
Gilts (19)	339	171	92.0	17.4
< 5 Yrs (2)	49	33	13.4	3.1
5 – 15 Yrs (4)	88	59	23.8	8.7
> 15 Yrs (13)	202	79	54.9	24.6
Non Gilts (47)	29	17	8.0	17.8

Table 2g: High Yield bond yields (BB-B indices)

Month End	US (%)	Euro (%)	Sterling (%)
Sep 11	8.65	10.58	11.27
Oct 11	7.62	9.05	10.31
Nov 11	8.10	10.98	11.69
Dec 11	7.48	11.08	11.43
Jan 12	6.99	9.40	10.21

