

## Investment Update December 2012



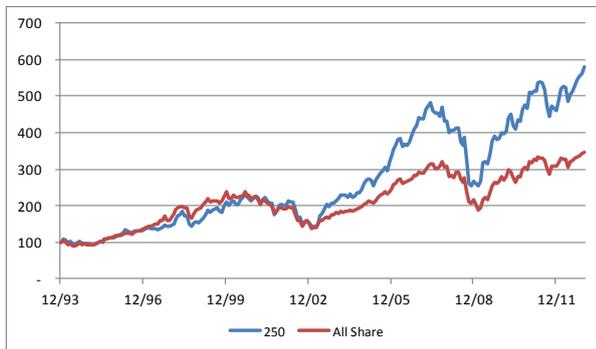
### Investment Headlines & Comment

- **Schroders** is buying **STW**, a US investment grade Fixed Income manager, thus adding nearly \$12bn to its own £203bn of assets under management.
- **Towers Watson** is buying **OXIP**, to provide fund management to its clients. As with previous multi-manager tie-ins, this will raise questions of conflict of interest.
- The current maturity cap on **gilt issuance** set at around 50 years is to be removed, to allow new issuance in the 50-60 year area but with no new perpetual gilts.

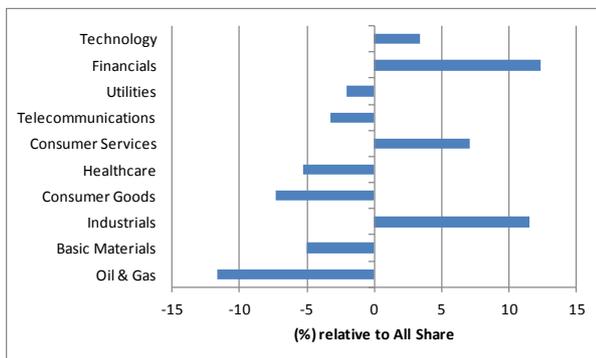
### Feature Section

This month we consider the FTSE 250 section of the UK Equity market (i.e. the companies ranked 101-350 by size in the All Share index). The profile of the UK market has changed significantly over time, with global companies choosing more about where they want to be listed, so it is plausible that the profile of the FTSE 250 has also changed over time. For active managers, these entrants and exits may also have offered more opportunities to produce good returns versus a conventional All Share index benchmark, but the median manager remains 0.5% p.a. behind the All Share over 10 years (*source: CAPS pooled survey to 30 September 2012*).

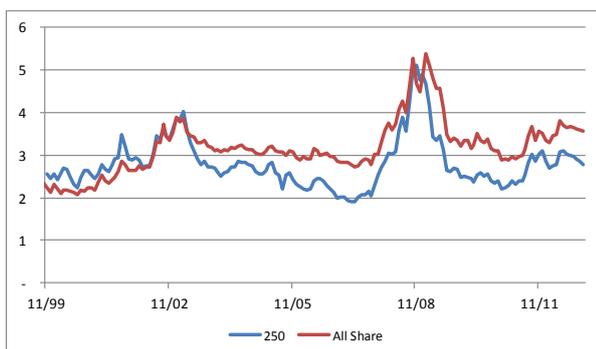
**Figure 1a: Cumulative total returns (12/93 =100)**



**Figure 1b: FTSE250 Sector deviations**



**Figure 1c: Comparison of dividend yields**



Source: FTSE

Figure 1a shows the cumulative returns on the FTSE250 and the All Share index, since the subset started to be published at the end of 1993. During the tech bubble and its subsequent contraction through to December 2002, there was very little difference between the FTSE250 and the All Share in terms of the cumulative return. However, over the 10 years since that point, the FTSE250 initially rallied strongly in relative terms, then lost much of it, and has then rallied again (now being ahead by 5.5% p.a. over the last 10 years, albeit with volatility of 18% p.a. versus 14% p.a. for the All Share).

It is fair to ask how much difference there is in sector weightings between the FTSE250 and the All Share. Figure 1b shows the current deviations (as at December 2012). At the moment, the major overweightings are in Industrials and Financials, with the main underweighting being for Oil & Gas. The current sector classifications came in during early 2006, and the major change since then has been the increase in Financials within the FTSE250 relative to the All Share (for example, in March 2006, the FTSE250's financials weighting was virtually the same as the All Share's).

In terms of dividend yield, the FTSE 250 has a current income yield of 2.8% (as at December 2012) versus 3.5% for the All Share. It has not always been that way. Figure 1c shows the FTSE250 had a higher yield during the technology bubble in the late 90s and very early 00s, and there have been points since then when the two have had similar yields. However, in general, since 2002 the FTSE250 has had a lower yield than the All Share.

Over the last 20 years, the FTSE 250 has gone from being about 20% of the overall All Share index down to about 11% in 2001, and since then it has fluctuated in a relatively narrow band, being 13.5% at the end of December 2012. (Over the same period, the FTSE 100 has gone from being about 75% of the overall All Share index up to about 85% in 2001, and since then it has fluctuated in a relatively narrow band, being 84% at the end of December 2012.) The simplest route for exposure to the FTSE 250 would be an Exchange Traded Fund (ETF) – iShares' is £550m in size.



**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 December 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	1.0	3.8	12.3	7.5	2.5	8.8	7.8
Overseas Equities	1.0	2.4	12.1	6.9	3.8	8.8	7.2
US Equities	-0.5	-0.9	11.2	10.6	6.0	7.3	<b>8.8</b>
Europe ex UK Equities	2.1	<b>7.9</b>	17.4	2.1	<b>-0.8</b>	9.6	7.8
Japan Equities	<b>3.9</b>	5.1	3.3	2.3	0.0	4.8	<b>0.8</b>
Pacific ex Japan Equities	1.8	5.5	<b>17.5</b>	7.4	5.2	15.7	8.7
Emerging Markets	3.5	5.0	13.4	4.8	3.4	<b>16.8</b>	8.6
UK Long-dated Gilts	-0.9	-0.2	2.9	<b>12.2</b>	8.9	6.7	<b>8.8</b>
UK Long-dated Corp. Bonds	-0.4	1.6	13.1	11.5	8.2	6.5	-
UK Over 5 Yrs Index-Linked Gilts	1.0	5.0	0.5	10.6	8.1	7.7	7.8
High Yield (Global)	0.7	3.9	14.1	11.5	<b>14.8</b>	10.9	-
Overseas Bonds	<b>-2.6</b>	<b>-2.6</b>	<b>-3.6</b>	4.4	10.2	6.1	5.9
Property *	0.0	0.5	2.6	9.4	<b>-0.8</b>	5.8	8.5
Cash	0.0	0.1	0.8	<b>0.8</b>	1.8	<b>3.3</b>	4.7
Commodities £-converted	<b>-2.0</b>	<b>-3.9</b>	<b>-4.3</b>	2.3	<b>-4.4</b>	2.7	3.3
Hedge Funds original \$ basis *	0.3	1.3	4.3	3.5	1.4	6.5	9.9
Illustrative £-converted version *	0.8	0.3	2.4	4.3	6.6	6.2	9.6
Euro relative to Sterling	<b>-0.1</b>	1.8	<b>-2.9</b>	<b>-3.0</b>	2.0	2.2	-
US \$ relative to Sterling	<b>-1.4</b>	<b>-0.6</b>	<b>-4.4</b>	<b>-0.2</b>	4.1	<b>-0.1</b>	<b>-0.4</b>
Japanese Yen relative to Sterling	<b>-5.9</b>	<b>-10.6</b>	<b>-14.9</b>	2.3	9.6	3.1	1.5
Price Inflation (RPI) *	0.0	1.1	3.0	4.3	3.2	3.3	2.9
Price Inflation (CPI) *	0.2	1.1	2.6	3.6	3.3	2.6	2.2
Price Inflation (RPIX) *	0.1	1.1	2.9	4.3	3.9	3.3	2.9
Earnings Inflation **	<b>-0.7</b>	<b>-1.6</b>	1.2	1.8	1.9	3.0	3.4
All Share Capital Growth	0.9	3.2	8.2	3.9	<b>-1.2</b>	5.0	4.2
Net Dividend Growth	0.1	1.2	9.8	7.7	2.2	5.1	-
Earnings Growth	<b>-0.1</b>	<b>-0.4</b>	<b>-6.9</b>	20.1	<b>-1.5</b>	9.9	-

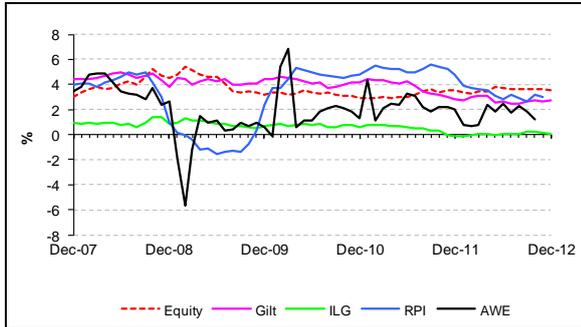
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

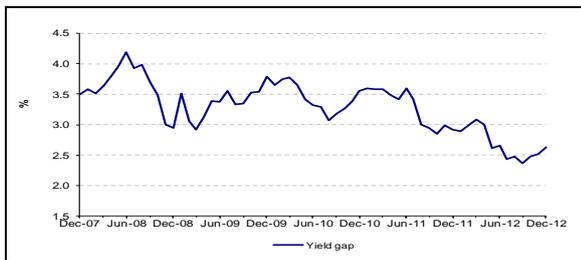


## Yields and Yield Gaps

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.

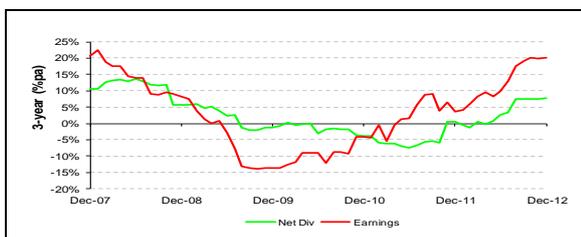
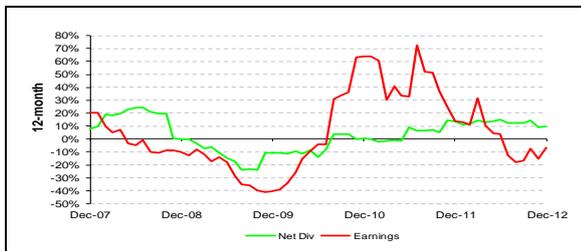


The gap gives a current expectation of just over 2.5% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

## 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]

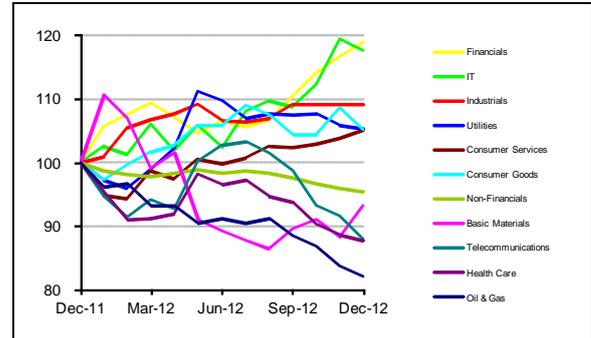
Figure 3: Dividend & Earnings Growth



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



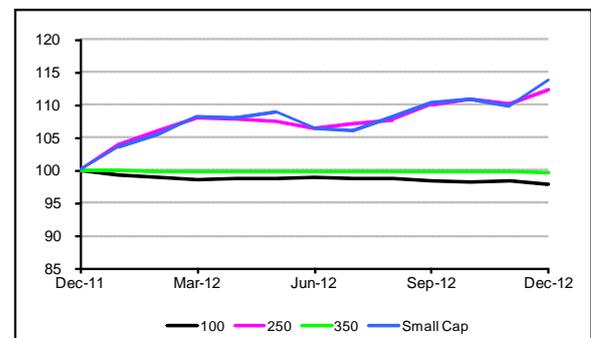
Note: Sector labels for relative lines are in end-value order

There was a small rise this month in the rolling 12-month sector dispersion (up from 35% to 37%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-1.0	-3.8	-7.9
Basic Materials	6.7	8.2	4.7
Industrials	0.9	3.8	22.5
Consumer Goods	-2.2	4.6	18.0
Health Care	0.0	-2.9	-1.5
Consumer Services	2.3	6.7	18.2
Telecommunications	-3.0	-7.6	-1.3
Utilities	0.4	1.8	18.3
Non-Financials	0.4	1.6	7.3
Financials	3.0	11.9	33.6
IT	-0.5	12.2	32.1
All Share	1.0	3.8	12.3

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid and Small Cap rose in relative terms this month.

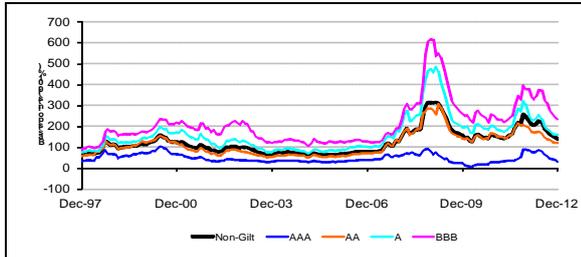
## FRS17 volatility indicator

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 (%)
July 12	3.86	2.47	1.39
Aug 12	3.86	2.50	1.36
Sep 12	3.98	2.60	1.38
Oct 12	3.98	2.72	1.26
Nov 12	3.92	2.64	1.28
Dec 12	<b>4.03</b>	<b>2.71</b>	<b>1.32</b>

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

Category	Mkt Val (£bn @ Dec 12 & 09, 06)			Weight (%)
Gilts (36)	1,112	693	319	67.6
Non Gilts (1,031)	533	461	405	32.4
AAA (162)	135	139	149	8.2
AA (164)	74	60	63	4.5
A (358)	177	163	123	10.8
BBB (347)	147	95	64	8.9

Category	Mkt Val (£bn @ Dec 12, & 09)		W't (%)	Dur'n (yrs)
Gilts (36)	1,112	693	67.6	9.7
< 5 Yrs (10)	309	205	18.8	2.7
5-15 Yrs (10)	360	234	21.9	6.9
> 15 Yrs (16)	443	254	26.9	16.8
Non Gilts (1,031)	533	461	32.4	7.9
< 5 Yrs (297)	146	142	8.9	2.7
5-15 Yrs (443)	216	187	13.2	7.2
> 15 Yrs (291)	170	132	10.4	13.4

**£ Gilt Market “main” Issuance**

- o £3.53bn 1¾% 2022 (1.69x, 1.80%, Oct 12)
- o £1.13bn 1/8% IL 2024 (2.37x, ry -0.58%, Oct 12)
- o This was a pretty quiet month for issuance!
- o Q1 2013 will include 2044 and 2052 issuance.  
*Note: Issuance amounts are nominals.*

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (262)	4,668	58.1
Non Sovereigns	3,367	41.9
AAA (538)	1,148	14.3
AA (385)	614	7.6
A (776)	913	11.4
BBB (674)	692	8.6

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (852)	2,233	27.8
3 – 5 Yrs (729)	1,828	22.8
5 – 7 Yrs (392)	1,065	13.3
7 – 10 Yrs (455)	1,496	18.6
10+ Yrs (207)	1,413	17.6

**Table 2f: Breakdown of £ Index-Linked Market**

Category (Number of issues)	Mkt Val (£bn @ Dec 12 & 09)		W't (%)	Dur'n (yrs)
Gilts (21)	340	211	92.0	18.5
< 5 Yrs (2)	45	35	12.0	3.9
5 – 15 Yrs (5)	97	83	26.3	9.9
> 15 Yrs (14)	198	93	53.6	26.1
Non Gilts (43)	30	21	8.0	17.2

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

Month End	US (%)	Euro (%)	Sterling (%)
Jul 12	6.61	8.53	10.36
Aug 12	6.45	7.80	9.68
Sep 12	6.29	7.31	8.94
Oct 12	6.19	6.81	8.36
Nov 12	6.13	6.36	8.02
Dec 12	<b>5.89</b>	<b>* 5.17</b>	<b>* 6.43</b>

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

Note: \* MLX methodology changed this month, so indices with significant “fixed-to-float” constituents now appear low-yielding, whereas specific High Yield fund yields may be somewhat different.

