



Investment Update January 2013

Investment Headlines & Comment

- The **RPI** method is to remain largely unchanged (our guest contributor predicted this in our October 2012 edition!).
- A Global Equity team hopped from **Odey** to **Majedie** in 2010, and now to **Marathon** to replace a founder investment manager.
- **The Pension Regulator** is consulting on a code of practice for their DC principles – see our June 2012 *Update* on those.

Feature Section

This month we revisit the subject of Gold, last considered in our January 2009 edition. Back then, the “credit crunch” equity falls were in progress, although they were only a couple of months from their eventual turning points. Gold had risen by 86% over the previous 2 years, and it was fair to ponder if there was a gold bubble. We also noted the high monthly volatility, so there were two apparent reasons for investors to be wary. It turned out that investors’ fear of other things was far stronger than might have been imagined, as Gold has risen by a further 71% over the subsequent 4 years. (**Ed.:** That’s 21% p.a. compound over the last six years.)

Figure 1a: Gold prices & inflation since 1968

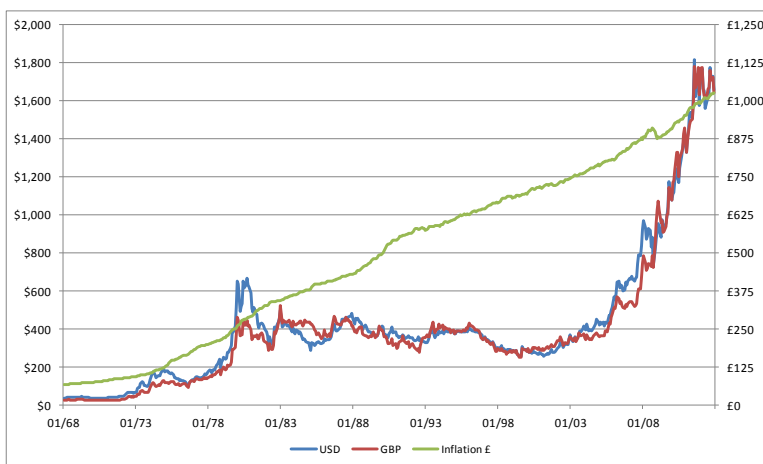
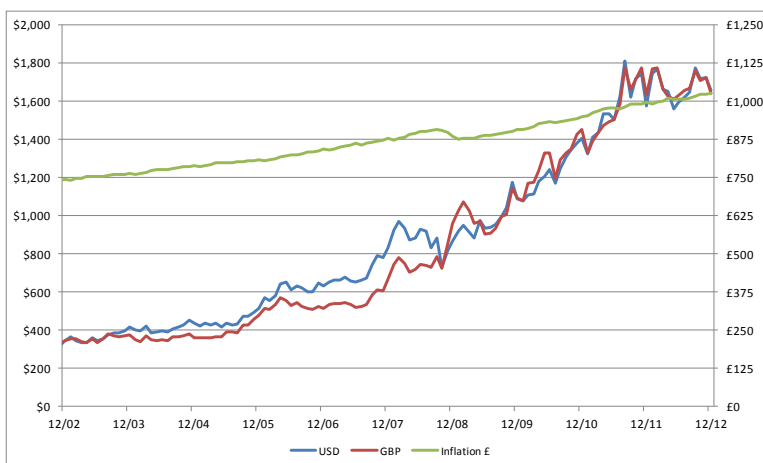


Figure 1b: Gold prices & inflation – the last 10 years



Sources: LBMA, ONS

Using updated monthly returns data since January 1992, we have again found that Gold has shown a low (positive) correlation with most other asset classes, Overseas Bonds having the largest correlation value (at 0.4). Therefore, on that basis some may still see it as a good diversifier although it arguably risks being so if the scenario arises of it going into persistent decline (in the way that Japanese equities have been for the last 20+ years). Before the Gold bulls assert that this could never happen, note from Figure 1a that the (US) Gold price peaked at \$667 at month end September 1980, then worked its way back down to \$258 at month end March 2001, more than 20 years later. Some things play out slowly but a cumulative loss of over 60% could hardly be termed a good investment ...

Figure 1a shows the monthly gold fix price in US Dollars and Sterling since 1968, along with the UK inflation index – the ratio between the gold prices at any date simply reflects the currency exchange rate. (The inflation index is rescaled to fit the end Sterling gold price. See our January 2009 edition for background on how the Gold market operates, and some supply/demand discussion too.)

As the horizontal axis in Figure 1a covers a long time period, Figure 1b shows the same data for just the last 10 years. Interestingly, as well as showing the pretty relentless rise from late 2005 to mid 2011, this brings out how the gold price has varied within a relatively tight band for the last 18 months or so, but with sharp jumps up and down.

Although it generates no income, and is potentially vulnerable to runs of speculation (criticisms which can be applied to other commodities as well, such as oil), Gold still forms a part of the asset allocation for many “absolute return” funds, which seek to provide stable longer term returns.

The main reason it has been held in recent years was as a “store of wealth” as it was expected to benefit from central banks (principally the Federal Reserve) “printing money” in an attempt to stimulate economic growth. If that policy is reduced, then the Gold price could fall by far more than the 7% drop seen in Q4 2012.



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 2013

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	6.4	9.3	16.3	11.1	5.7	10.5	8.1
Overseas Equities	7.3	10.4	15.0	10.8	7.0	10.1	7.5
US Equities	8.0	8.7	16.4	14.5	9.0	8.6	9.1
Europe ex UK Equities	9.4	15.7	22.7	7.1	3.4	11.2	8.1
Japan Equities	6.3	13.6	6.8	3.5	2.0	6.1	1.1
Pacific ex Japan Equities	5.4	10.3	13.9	11.3	9.1	16.3	8.8
Emerging Markets	3.9	9.4	7.5	7.9	7.1	17.5	8.7
UK Long-dated Gilts	-3.6	-3.0	-1.5	10.5	8.1	6.1	8.6
UK Long-dated Corp. Bonds	-2.4	-1.5	8.0	9.7	7.9	6.0	-
UK Over 5 Yrs Index-Linked Gilts	4.5	9.3	4.5	12.2	8.7	8.0	7.9
High Yield (Global)	4.2	6.6	16.2	12.2	16.1	11.2	-
Overseas Bonds	1.2	-1.0	-2.1	4.4	9.6	6.3	5.8
Property *	0.3	0.5	2.4	8.2	0.1	5.8	8.5
Cash	0.0	0.1	0.8	0.8	1.8	3.3	4.7
Commodities £-converted	6.9	6.9	1.6	7.3	-3.0	2.7	3.5
Hedge Funds original \$ basis *	1.5	1.5	6.4	3.6	1.6	6.7	9.8
Illustrative £-converted version *	0.1	0.9	1.7	3.4	5.7	6.6	9.4
Euro relative to Sterling	5.6	6.4	3.2	-0.4	2.8	2.7	-
US \$ relative to Sterling	2.5	1.6	-0.5	0.3	4.6	0.4	-0.3
Japanese Yen relative to Sterling	-2.9	-11.0	-16.9	0.1	7.9	3.1	1.2
Price Inflation (RPI) *	0.5	1.1	3.1	4.2	3.2	3.3	2.9
Price Inflation (CPI) *	0.5	1.2	2.7	3.5	3.3	2.6	2.2
Price Inflation (RPIX) *	0.4	1.0	3.0	4.2	3.9	3.3	2.9
Earnings Inflation **	0.1	-0.8	1.1	1.8	1.7	3.0	3.4
All Share Capital Growth	6.3	8.7	12.1	7.3	1.8	6.7	4.5
Net Dividend Growth	0.3	1.2	12.4	7.6	2.1	5.2	-
Earnings Growth	0.4	0.6	-6.5	20.2	-1.5	10.0	-

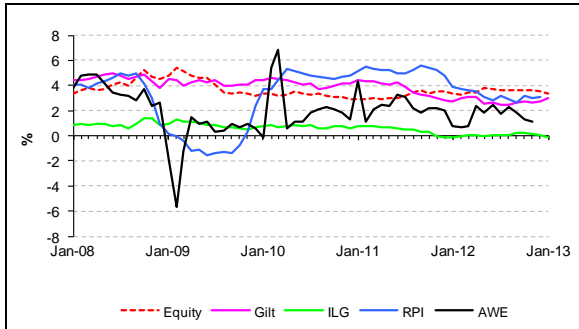
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

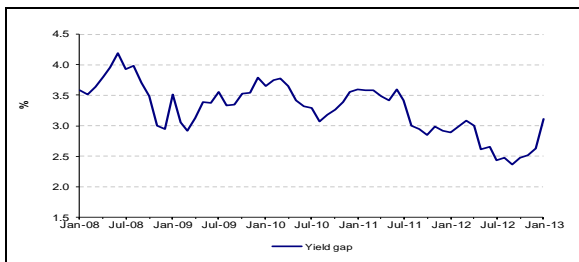


Yields and Yield Gaps

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.

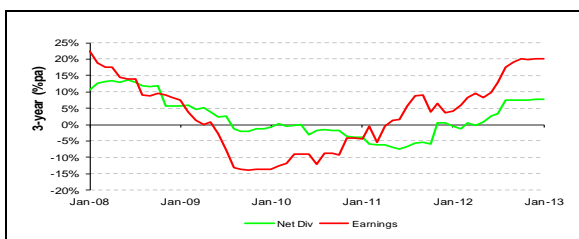
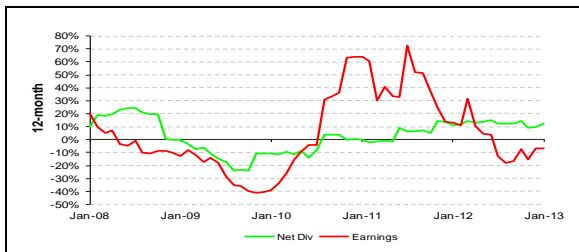


The gap gives a current expectation of just over 3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

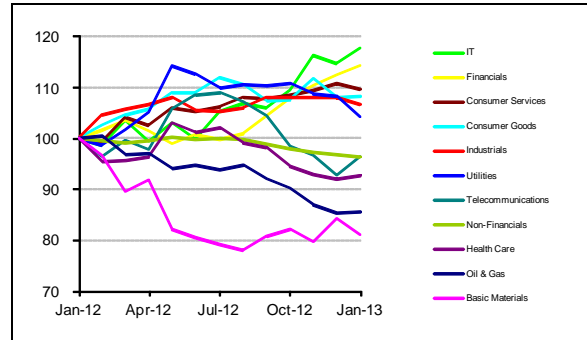
Figure 3: Dividend & Earnings Growth



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



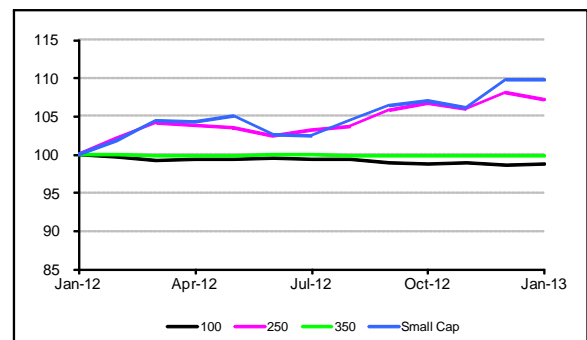
Note: Sector labels for relative lines are in end-value order

There was no change this month in the rolling 12-month sector dispersion (still at 37%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	6.8	3.8	-0.4
Basic Materials	2.2	7.6	-5.8
Industrials	5.1	8.0	24.2
Consumer Goods	6.6	10.2	26.1
Health Care	7.4	7.2	7.9
Consumer Services	5.1	10.4	27.5
Telecommunications	10.5	7.1	12.2
Utilities	2.3	2.7	21.1
Non-Financials	5.9	7.5	12.1
Financials	8.0	15.7	32.9
IT	9.2	17.6	36.9
All Share	6.4	9.3	16.3

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap fell slightly in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.



Bond market information

Figure 5: £ Non-Gilt Credit Margins

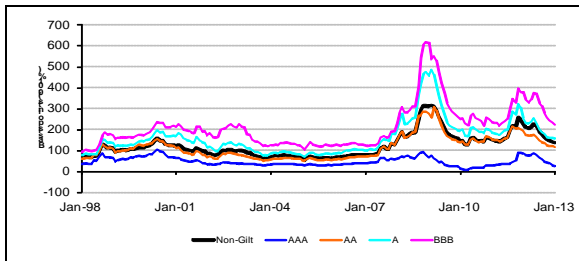


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Aug 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	4.03	2.71	1.32
Jan 13	4.26	2.99	1.27

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

Category	Mkt Val (£bn @ Jan 13 & 10, 07)			Weight (%)
	Jan 13	Jan 10	Jan 07	
Gilts (36)	1,092	697	307	67.6
Non Gilts (1,025)	523	474	402	32.4
AAA (153)	127	149	146	7.9
AA (164)	73	756	63	4.5
A (360)	176	167	123	10.9
BBB (348)	148	83	67	9.1

Category	Mkt Val (£bn @ Jan 13, & 10)		W't (%)	Dur'n (yrs)
Gilts (36)	1,092	697	67.6	9.4
< 5 Yrs (10)	308	205	19.1	2.7
5-15 Yrs (11)	393	236	24.3	7.2
> 15 Yrs (15)	392	256	24.2	16.9
Non Gilts (1,025)	523	474	32.4	7.9
< 5 Yrs (291)	145	147	9.0	2.8
5-15 Yrs (442)	212	197	13.1	7.2
> 15 Yrs (292)	166	130	10.3	13.3

£ Gilt Market “main” Issuance

- o £3.75bn 1% 2017 (2.11x, 0.96%, Nov 12)
 - o £1.92bn 4% 2022 (2.91x, 1.90%, Apr 12)
 - o £1.65bn 4¾% 2030 (1.83x, 2.79%, Jul 12)
 - o £4.00bn 3¼% 2044 (2.43x, 3.42%, Oct 12)
 - o £1.00bn 1/8% IL 2029 (2.02x, ry -0.37%, Aug 12)
- Note: Issuance amounts are nominals.

Tables 2d, 2e: € Market Size and Maturity (Jan 13)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (260)	4,617	58.1
Non Sovereigns	3,330	41.9
AAA (525)	1,052	13.2
AA (400)	675	8.5
A (785)	906	11.4
BBB (682)	697	8.8

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (850)	2,196	27.6
3 – 5 Yrs (727)	1,811	22.8
5 – 7 Yrs (404)	1,063	13.4
7 – 10 Yrs (459)	1,483	18.7
10+ Yrs (212)	1,394	17.5

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jan 13 & 10)		W't (%)	Dur'n (yrs)
Gilts (21)	355	211	92.0	18.8
< 5 Yrs (2)	45	35	11.7	3.9
5 – 15 Yrs (5)	99	84	25.8	9.9
> 15 Yrs (14)	210	92	54.6	26.3
Non Gilts (43)	31	22	8.0	17.4

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

Month End	US (%)	Euro (%)	Sterling (%)
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	5.89	* 5.17	* 6.43
Jan 13	5.76	5.27	6.30

Sources: Barclays Capital, DMO, iBoxx, J&A, MLX
Note: * MLX methodology changed in Dec 2012, so indices with significant “fixed-to-float” constituents now appear low-yielding, whereas specific High Yield fund yields may be somewhat different.

