



Investment Update November 2013

Investment Headlines & Comment

- **DWP Auto Enrolment** analysis shows an opt-out rate of about 10%, but has anyone yet confirmed the savings for those who stay in won't be offset by means testing?
- **Asset-backed contributions** [guidance](#) from the Pension Regulator tells Trustees to proceed with caution. The self-investment aspect has still to be tested in court.
- **Defined Ambition** consultation is starting on trying to retain some less-guaranteed elements of defined benefit provision – back to the 70s after the horse has bolted?

Feature Section

This month we revisit a subject last covered in our April 2004 issue, on the relative returns for high-yielding and low-yielding equities within the FTSE 350.

The FTSE350 is the index for the largest 350 companies in the UK. It has been published with a subdivision into high (dividend) yield and low yield since the beginning of 1995 (with a backhistory as well, for those who like extensive data) – sometimes these can be thought of as “value” and “growth” subsets. Stocks move between the two subsets on an annual basis so as to maintain a 50/50 split by market capitalization between the subsets.

Figure 1a shows the total returns for the FTSE350 and the two complementary subsets, scaled to a start of 1000 as of the end of December 1994. (All data for Figures 1a-1c is sourced from FTSE.) For the first 4 years, there was hardly any difference between the subsets. With the technology bubble in late 1999 there was a brief period when low yielding stocks were just over 10% ahead of the index as a whole (and high yield stocks were 10% behind, as expected from the subsets' complementary definitions), and then parity resumed in late 2000. However, in the next 2 years or so, high yield stocks gained over 30% relative to the overall index (and low yield stocks lost a corresponding amount) – see the April 2004 edition's version of Figure 1b for just how rapidly this happened.

Figure 1b shows the latest 10 years' cumulative returns for the two subsets relative to the FTSE350 as a whole (with that kept at 100 for ease of reading). There have been some periods where there was a clear difference between the subsets, but for the last two years or so, the fluctuations have been within a relatively narrow range. So, managers should not find that any high- or low-dividend bias has worked against them. By contrast, given the dispersion of returns for UK Equities by size shown in our April 2013 edition, there has been considerable benefit for those with a Mid Cap bias.

Figure 1a: Absolute total returns

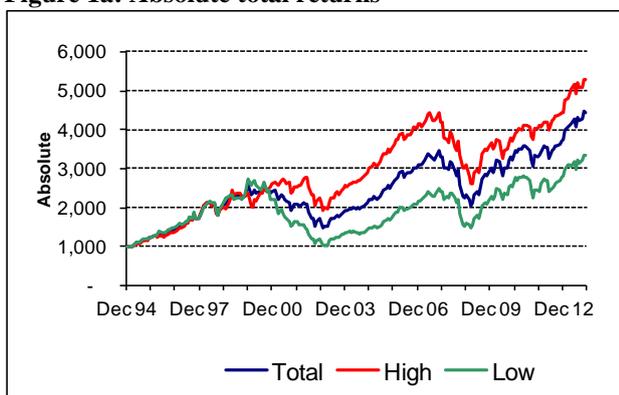


Figure 1b: Relative returns over the last 10 years

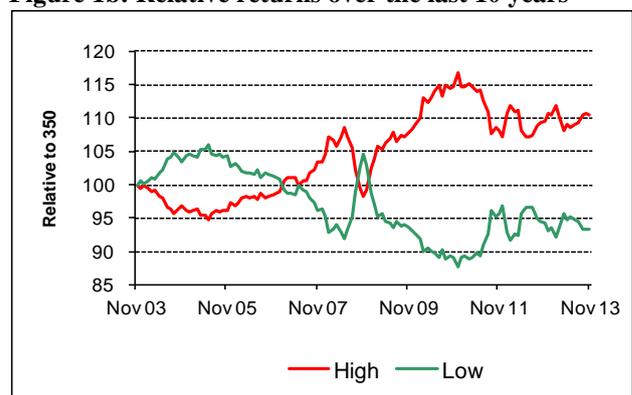
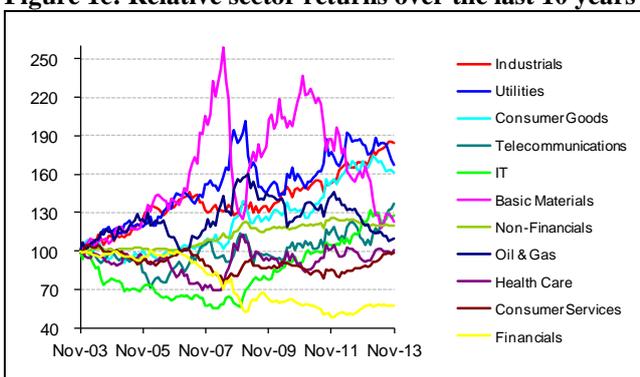


Figure 1c: Relative sector returns over the last 10 years



Finally, as per our April 2013 edition, the dispersion of sector returns is much more dramatic, with some marked sharp turning points. Figure 1c shows this for the main sector groups over the same time period as Figure 1b (and Figure 1c is an extended version of our Figure 4a, again with data labels in end value order for ease of reference). You might *think* of some sub-sectors being more likely to be on one side than the other, e.g. Oil & Gas, Utilities on High, Industrials and Technology on Low. However, the split for High and Low in the FTSE350 is entirely mechanical, so you do not get whole sectors (or even sub sectors) on one side or other of the divide, or even staying on one side.



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 30 November 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	-0.7	4.7	19.8	11.3	14.7	8.9	7.8
Overseas Equities	-0.5	4.9	21.8	10.4	14.7	9.0	7.3
US Equities	0.9	4.8	27.7	15.8	16.3	8.5	8.8
Europe ex UK Equities	-0.9	8.0	25.8	10.1	13.1	9.5	8.7
Japan Equities	-0.5	3.9	30.3	6.6	7.8	5.3	0.9
Pacific ex Japan Equities	-3.0	3.7	5.5	3.3	18.4	13.1	6.4
Emerging Markets	-3.3	4.0	1.8	-0.7	15.7	13.0	6.5
UK Long-dated Gilts	-1.7	0.8	-5.7	7.7	6.7	6.4	7.2
UK Long-dated Corp. Bonds	-1.9	2.1	-0.2	8.7	10.5	6.2	-
UK Over 5 Yrs Index-Linked Gilts	-0.7	1.7	3.6	9.4	10.1	7.6	7.1
High Yield (Global)	-1.5	-1.1	6.9	8.4	19.5	9.6	-
Overseas Bonds	-3.2	-4.4	-6.8	0.1	2.5	5.3	5.1
Property *	1.1	3.2	7.4	6.4	4.5	5.6	8.4
Cash	0.0	0.1	0.5	0.7	0.9	3.0	4.4
Commodities £-converted	-2.7	-10.8	-5.8	-0.1	-0.8	1.6	3.5
Hedge Funds original \$ basis *	1.6	2.5	9.2	3.7	6.9	5.8	9.0
Illustrative £-converted version *	2.4	-3.3	9.5	3.5	7.0	6.4	8.5
Euro relative to Sterling	-1.7	-2.5	2.4	-0.2	0.1	1.8	-
US \$ relative to Sterling	-1.9	-5.6	-2.1	-1.7	-1.3	0.5	-0.5
Japanese Yen relative to Sterling	-6.0	-9.5	-21.2	-8.0	-2.7	1.2	-0.2
Sterling trade weighted	2.4	3.9	1.5	1.3	0.1	-1.4	-0.2
Price Inflation (RPI) *	0.0	0.9	2.6	3.7	3.0	3.3	2.9
Price Inflation (CPI) *	0.1	0.9	2.2	3.3	2.9	2.7	2.2
Price Inflation (RPIX) *	0.0	0.9	2.7	3.8	3.5	3.3	2.9
Earnings Inflation **	-0.1	-3.1	0.8	1.4	1.5	2.8	3.4
All Share Capital Growth	-1.0	4.0	15.8	7.4	10.7	5.2	4.2
Net Dividend Growth	0.8	0.1	7.4	10.3	3.5	5.6	-
Earnings Growth	13.8	11.7	-3.2	0.8	-0.2	7.6	6.5

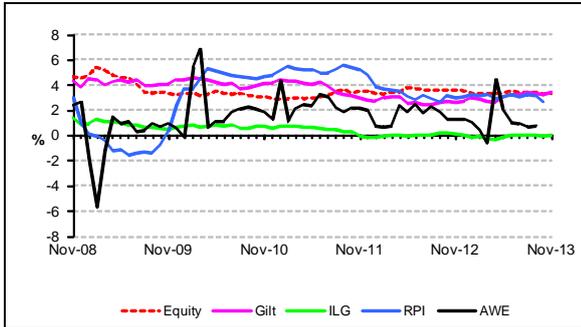
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

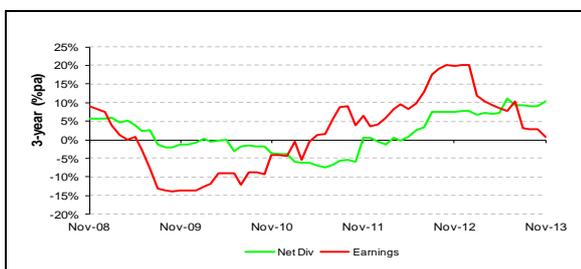
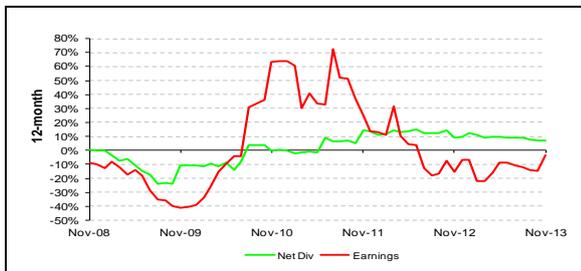


The gap gives a current expectation now clearly moving to 3.5% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

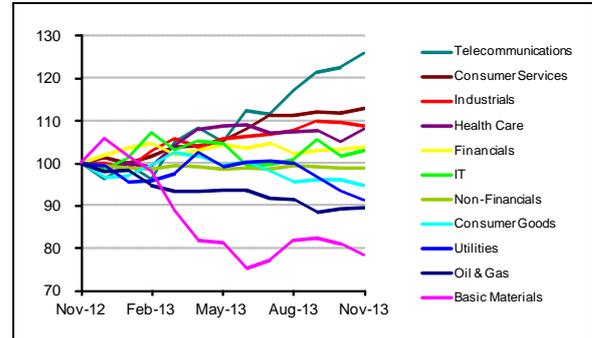
Figure 3: Dividend & Earnings Growth



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



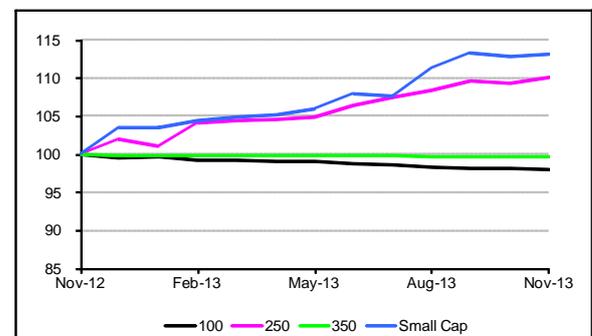
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (from 42% to 47%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-0.5	2.4	7.3
Basic Materials	-4.0	0.2	-6.1
Industrials	-1.3	5.8	30.4
Consumer Goods	-2.0	3.7	13.5
Health Care	2.1	5.1	29.3
Consumer Services	0.2	6.2	35.2
Telecommunications	1.8	12.3	50.6
Utilities	-3.2	-4.4	9.2
Non-Financials	-0.8	4.2	18.5
Financials	-0.4	6.3	24.3
IT	0.9	7.1	23.6
All Share	-0.7	4.7	19.8

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap and Small Cap both rose slightly in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.



Bond market information

Figure 5: £ Non-Gilt Credit Margins

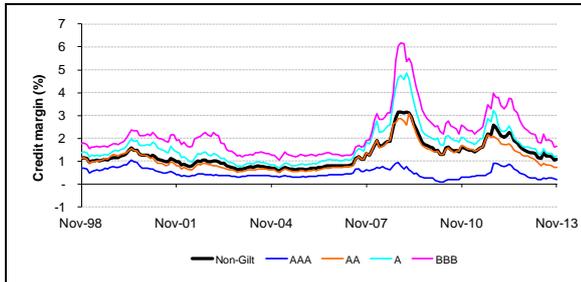


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jun '13	4.47	3.30	1.17
Jul '13	4.29	3.27	1.02
Aug '13	4.35	3.42	0.93
Sep '13	4.27	3.34	0.93
Oct '13	4.13	3.29	0.84
Nov '13	4.28	3.44	0.84

Tables 2b, 2c: £ Market Size (£bn) and Maturity

Category	Mkt Val @ Nov 13 & 10, 07			Weight (%)
	Nov 13	Nov 10	07	
Gilts (37)	1,071	820	335	67.2
Non Gilts (1,030)	523	476	429	32.8
AAA (139)	106	144	159	6.6
AA (165)	85	73	66	5.3
A (350)	165	165	133	10.4
BBB (376)	167	95	68	10.5

Category	Mkt Val @ Nov 13, & 10		W't (%)	Dur'n (yrs)
Gilts (37)	1,071	820	67.2	9.6
< 5 Yrs (10)	302	260	18.9	2.8
5-15 Yrs (11)	359	282	22.5	7.0
> 15 Yrs (16)	410	278	25.8	16.7
Non Gilts (1,030)	523	476	32.8	7.8
< 5 Yrs (307)	150	139	9.4	2.7
5-15 Yrs (439)	211	202	13.3	7.2
> 15 Yrs (284)	161	136	10.1	13.3

£ Gilt Market “main” Issuance

- o £4.75bn 1¾% 2019 (1.41x, 1.91%, Nov 12)
 - o £4.12bn 2¼% 2023 (1.80x, 2.73%, Oct 13)
 - o £2.47bn 4¼% 2036 (1.38x, 3.50%, Jan 11)
 - o £2.75bn 3¼% 2044 (1.67x, 3.61%, Sep 13)
 - o £1.25bn ILG ¼% 2052 (1.96x, r.y 0.03%, Feb 13)
- Note: Issuance amounts are nominals.

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (277)	4,842	59.4
Non Sovereigns	3,314	40.6
AAA (549)	1,053	12.9
AA (395)	663	8.1
A (747)	823	10.1
BBB (759)	775	9.5

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (790)	2,168	26.6
3 – 5 Yrs (723)	1,764	21.6
5 – 7 Yrs (504)	1,319	16.2
7 – 10 Yrs (485)	1,486	18.2
10+ Yrs (225)	1,420	17.4

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Nov 13 & 10)		W't (%)	Dur'n (yrs)
Gilts (23)	379	239	92.2	19.0
< 5 Yrs (2)	44	21	10.8	3.1
5 – 15 Yrs (6)	105	96	25.6	9.1
> 15 Yrs (15)	230	121	55.9	26.5
Non Gilts (43)	32	24	7.8	17.1

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

Month End	US (%)	Euro (%)	Sterling (%)
May 13	5.64	4.73	6.12
Jun 13	6.26	5.36	6.64
Jul 13	5.96	5.06	6.22
Aug 13	6.16	5.09	6.32
Sep 13	6.06	5.04	6.19
Oct 13	5.66	4.64	5.85
Nov 13	5.67	4.54	5.79

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

