



Investment Update July 2013

Investment Headlines & Comment

- The UK's **QE programme** is to be replaced by "market guidance" (but no clue on the timing for any sale of QE gilts yet).
- **Standard Life's** head of multi-asset is moving to **Aviva** – a challenge given 2012's scaling back of the investment operations?
- The **Church of England** has found its ethical criteria may not reach into controlling what its venture capital managers buy.

Feature Section

This month we return to Absolute Return funds, to update the 5-year analysis from our August 2012 edition for four more calendar quarters, and we start to consider trends in the associated dispersion statistics. The period of 5 years to June 2012 included all of the "credit crunch", whereas the 5 years to June 2013 have lost the first couple of quarters of it. As before, we use anonymised data for 11 well known providers. Funds with a below 5 year performance record are excluded. This time we are including a fund which is closed to new clients (you can argue both ways on its inclusion) – and another fund with a very narrow 'toolkit' from which to make its investment decisions.

Figure 1a shows the dispersion of the returns for the 5 years to June 2012, the 5 years to June 2013, and the underlying 6 years (from June 2007 to June 2013). Inevitably, the closed fund is the one at the top in each case, as something of an outlier, with the others spread across a 4% pa range for longer term data (which is a much wider dispersion that you would associate with groups of funds in specific asset classes). There is a wider spread for the '2012' 5-year dataset, with "diversified growth" funds doing noticeably worse than funds that made greater tactical use of bonds and cash.

Figure 1a: Dispersion statistics (annualised returns)

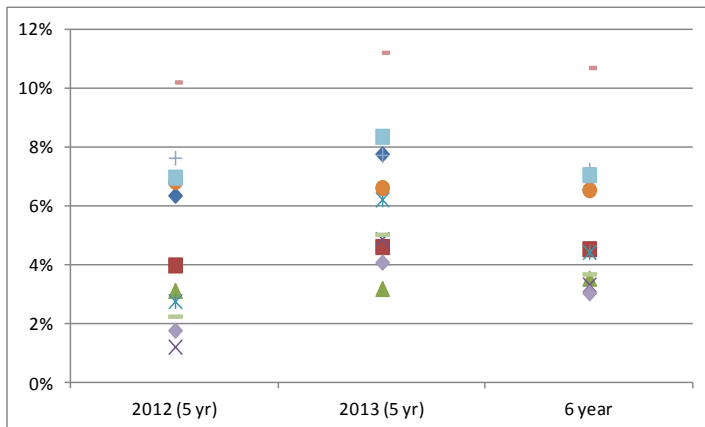
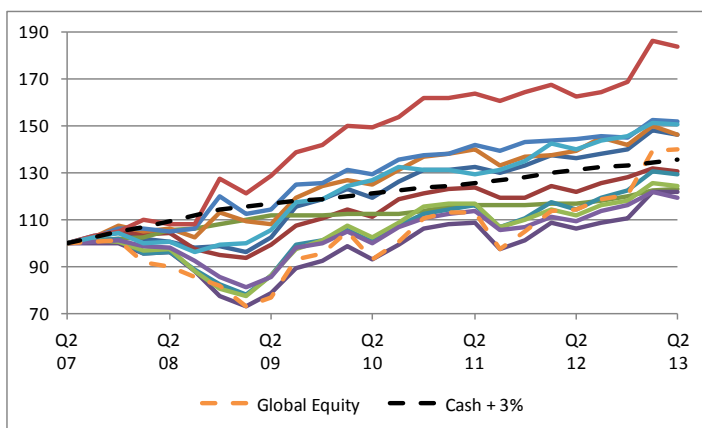


Figure 1b: Cumulative quarterly absolute returns



Sources: FTSE, Jagger & Associates

Pension schemes' expectations for these funds will need to be kept under review in their valuation assumptions, and it will also be interesting to see whether some lagging managers might actually abandon their products.

Some funds did exceptionally well in Q4 2008 (when trade-weighted sterling fell by about 20%, and US Treasury bond prices rose sharply), so the 5-year dispersion could change somewhat once that quarter drops out. By extension, repeatability is an interesting issue for some funds, as there may be scenarios where you would expect a specific manager to do particularly well or badly. For example, if a fund limits itself to large cap equities and government bonds, there has to be a concern on what it can produce prospectively (unless you envisage a flight to quality for some government bonds, as a response to a market shock such as a Eurozone separation?).

So, if you haven't got a crystal ball for which scenario is going to happen, then that gets you to adopting a set of managers rather than going for just the one product. (This is analogous to using a fund-of-funds arrangement for assets where index-tracking is not feasible, e.g. Property.)

Figure 1b shows the evolution of the returns (including dotted lines for Equities and Cash). Over the 6 years, 5 of the 11 managers have beaten equities, so thinking generally of Absolute Return funds as "equity replacements" is fair (although 4 managers lagged by over 2% p.a.). Further, 5 of the 11 managers are ahead of cash + 3% p.a., with 2 just lagging that, but that's with cash down at 2% p.a.



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 July 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	6.8	4.4	24.3	12.8	8.9	9.3	8.1
Overseas Equities	4.7	4.3	25.6	13.0	10.4	9.3	7.1
US Equities	5.3	9.0	29.6	19.1	14.4	8.6	9.0
Europe ex UK Equities	7.5	5.5	34.5	9.7	5.6	9.7	8.9
Japan Equities	0.8	-0.7	30.2	8.9	6.3	6.4	-0.2
Pacific ex Japan Equities	2.1	-5.5	11.5	7.0	10.4	13.9	7.5
Emerging Markets	1.2	-5.2	5.7	2.4	6.4	14.1	7.7
UK Long-dated Gilts	0.9	-7.2	-6.6	8.6	8.1	6.4	7.8
UK Long-dated Corp. Bonds	2.4	-6.1	1.2	8.7	8.9	6.1	-
UK Over 5 Yrs Index-Linked Gilts	0.3	-8.2	3.0	10.4	7.4	7.5	7.4
High Yield (Global)	2.2	1.2	15.6	11.4	17.6	10.2	-
Overseas Bonds	1.2	0.0	-1.5	2.9	9.5	5.9	5.6
Property *	0.8	1.9	4.1	6.0	1.9	5.6	8.5
Cash	0.0	0.1	0.5	0.8	1.2	3.1	4.5
Commodities £-converted	5.0	6.3	4.0	5.6	-7.3	2.4	3.7
Hedge Funds original \$ basis *	-1.5	-0.2	8.1	4.9	2.5	6.2	9.3
Illustrative £-converted version *	-1.5	-0.1	11.7	4.4	8.2	7.1	9.2
Euro relative to Sterling	2.2	3.3	11.4	1.7	2.1	2.3	-
US \$ relative to Sterling	0.1	2.6	3.4	1.1	5.5	0.6	-0.1
Japanese Yen relative to Sterling	1.1	1.7	-17.9	-3.1	7.5	2.7	0.2
Sterling trade weighted	-1.4	-2.0	-5.8	-1.2	-3.2	-1.9	-0.5
Price Inflation (RPI) *	-0.1	0.4	3.3	3.7	2.9	3.3	2.9
Price Inflation (CPI) *	-0.2	0.2	2.9	3.2	2.9	2.7	2.1
Price Inflation (RPIX) *	-0.1	0.4	3.3	3.7	3.4	3.3	2.9
Earnings Inflation **	-3.2	-4.5	1.7	2.0	1.6	3.0	3.5
All Share Capital Growth	6.7	3.5	19.9	8.9	5.0	5.5	4.5
Net Dividend Growth	0.0	2.0	8.7	9.3	-0.2	5.6	-
Earnings Growth	-6.3	-3.9	-11.0	10.3	-1.7	7.3	6.4

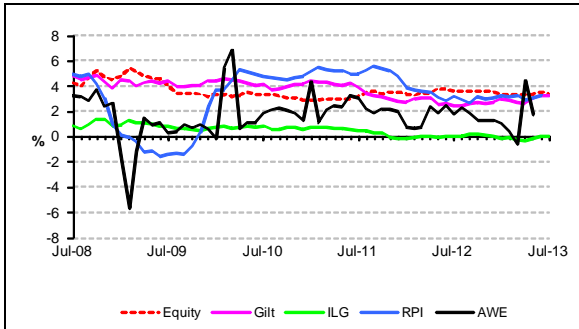
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

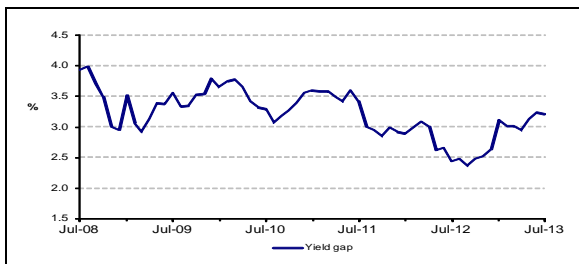


Yields and Yield Gaps

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.

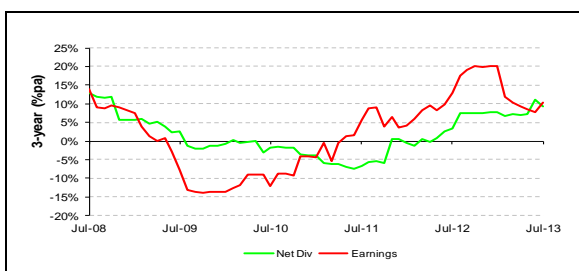
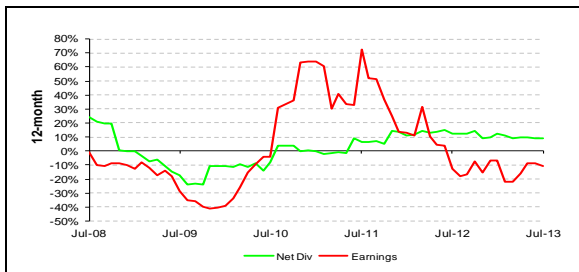


The gap gives a current expectation of now clearly over 3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

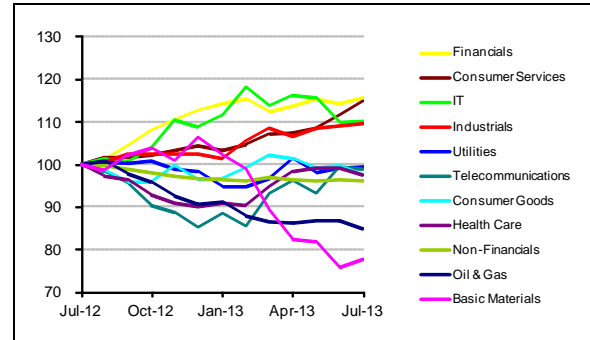
Figure 3: Dividend & Earnings Growth



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



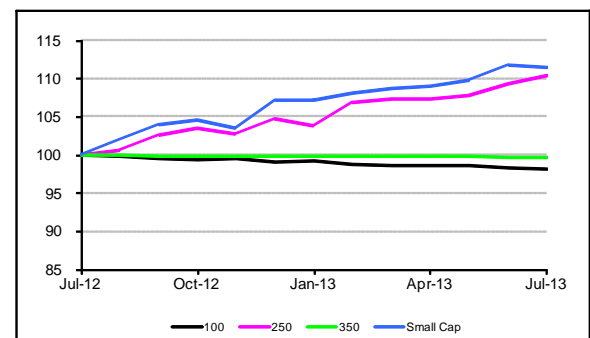
Note: Sector labels for relative lines are in end-value order

There was a slight fall this month in the rolling 12-month sector dispersion (from 42% to 38%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	4.5	2.6	5.5
Basic Materials	9.4	-1.5	-3.5
Industrials	7.4	7.3	36.2
Consumer Goods	4.4	0.6	21.3
Health Care	4.9	3.4	21.1
Consumer Services	10.0	11.6	42.8
Telecommunications	6.1	7.5	22.9
Utilities	6.9	2.2	23.5
Non-Financials	6.4	3.9	19.4
Financials	8.0	6.0	43.7
IT	7.0	-1.0	36.9
All Share	6.8	4.4	24.3

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap rose but Small Cap fell in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.



Bond market information

Figure 5: £ Non-Gilt Credit Margins

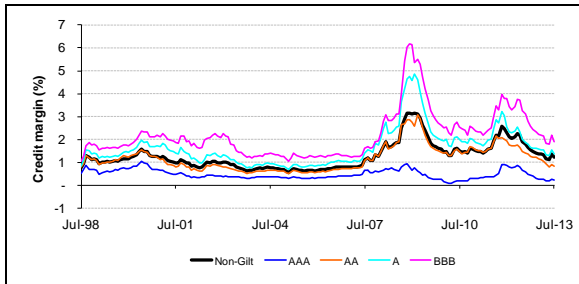


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Feb '13	4.18	2.94	1.24
Mar '13	4.01	2.76	1.25
Apr '13	3.75	2.63	1.12
May '13	4.02	2.96	1.06
Jun '13	4.47	3.30	1.17
Jul '13	4.29	3.27	1.02

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

Category	Mkt Val @ Jul 13 & 10, 07			Weight (%)
	Jul 13	Jul 10	07	
Gilts (38)	1,090	774	309	67.7
Non Gilts (1,020)	521	471	415	32.3
AAA (135)	106	142	151	6.6
AA (159)	83	72	63	5.2
A (357)	169	167	131	10.5
BBB (369)	163	90	68	10.1

Category	Mkt Val @ Jul 13, & 10		W't (%)	Dur'n (yrs)
Gilts (38)	1,090	774	67.7	9.3
< 5 Yrs (10)	315	221	19.6	2.7
5-15 Yrs (12)	375	297	23.2	7.1
> 15 Yrs (16)	400	256	24.8	16.8
Non Gilts (1,020)	521	471	32.3	7.9
< 5 Yrs (296)	148	132	9.2	2.8
5-15 Yrs (434)	208	207	12.9	7.2
> 15 Yrs (290)	166	131	10.3	13.2

£ Gilt Market “main” Issuance

- £3.85bn 2¼% 2023 (1.76x, 2.58%, Jun 13)
 - £2.58bn 3¼% 2044 (1.65x, 3.55%, May 13)
 - £1.49bn ILG 1/8% 2029 (1.80x, r.y -0.04%, Apr 13)
 - £4.00bn ILG 1/8% 2044 (2.20x, r.y 0.09%, May 13)
- Note: Issuance amounts are nominals.*

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (277)	4,806	59.7
Non Sovereigns	3,245	40.3
AAA (538)	1,049	13.0
AA (380)	630	7.8
A (754)	842	10.5
BBB (707)	725	9.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (808)	2,182	27.1
3 – 5 Yrs (731)	1,809	22.5
5 – 7 Yrs (427)	1,153	14.3
7 – 10 Yrs (469)	1,489	18.5
10+ Yrs (221)	1,417	17.6

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jul 13 & 10)		W't (%)	Dur'n (yrs)
Gilts (21)	362	239	92.1	18.6
< 5 Yrs (2)	44	36	11.3	3.4
5 – 15 Yrs (5)	101	93	25.7	9.5
> 15 Yrs (14)	217	110	55.1	26.0
Non Gilts (43)	31	23	7.9	16.9

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

Month End	US (%)	Euro (%)	Sterling (%)
Feb 13	5.76	5.07	6.33
Mar 13	5.69	5.11	6.24
Apr 13	5.43	4.66	5.89
May 13	5.64	4.73	6.12
Jun 13	6.26	5.36	6.64
Jul 13	5.96	5.06	6.22

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

