



Investment Update December 2014

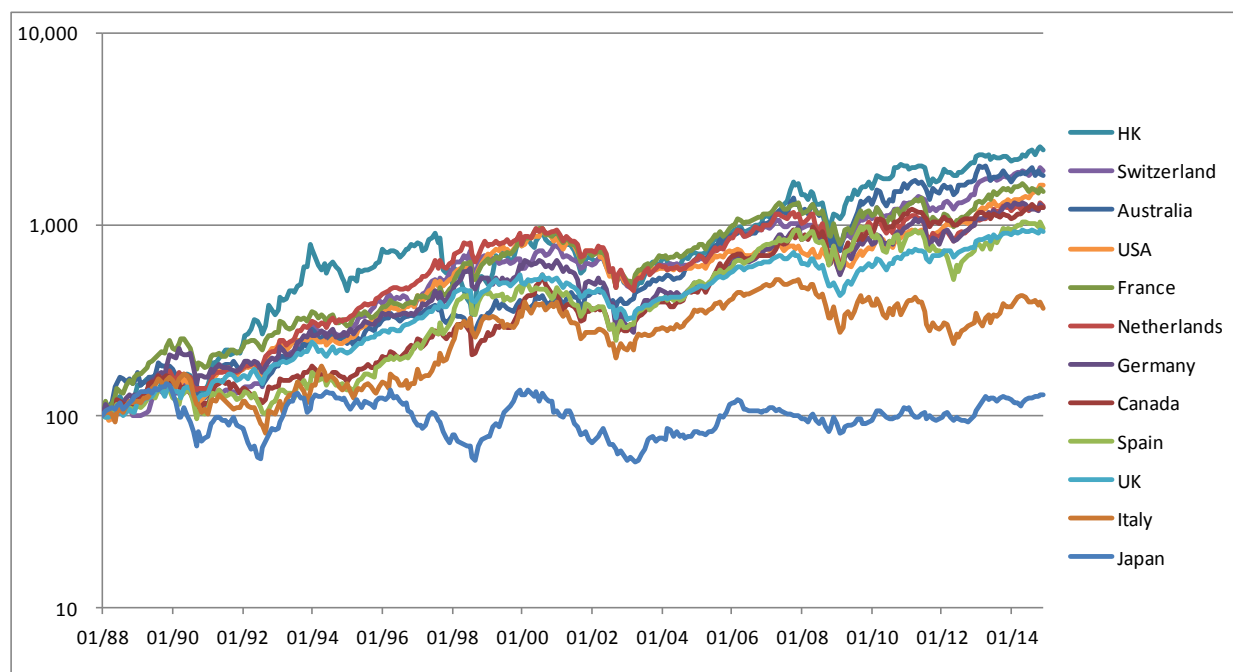
Investment Headlines & Comment

- **UK inflation** has dropped (for both RPI and CPI), reflecting the fall in fuel prices.
- **Real yields** have continued to head more negative, leading to a bizarre 26% return in 2014 for long gilts.
- In 2014, **Russia's** currency fell heavily, due to oil price falls, and Ukraine-related Western sanctions.

Feature Section This month we consider the long-run returns from different countries' equity markets, to see if there are any persistent trends. Figure 1 shows the total return indices (in sterling) for the current 8 largest equity markets of the FT All-World index (in descending order of size: USA, Japan, UK, Canada, Switzerland, France, Germany, Australia, which together account for c.80% of the index), plus Hong Kong, and three additional Eurozone markets - Netherlands, Spain, and Italy.

We use a log scale on the vertical axis, so that annual growth is interpreted as a sloping straight line, instead of an exponential curve. (The compounding involved for over 25 years means that using a conventional axis would increase the emphasis given to the most recent data.) The start date reflects the start date of the FTSE World indices. The legend on the right of the chart is in end-value order, for ease of reference. The country indices are the sub-indices within the FTSE World / All-World dataset, hence oriented to large cap stocks (e.g. there are only 129 stocks in the UK sub-index, so it is distinct from the All Share index).

Figure 1: Equity returns by Country (vertical axis on log scale)



Source: FTSE

Leaving aside Japan, there is a clear element of dispersion between markets in the early to mid 1990s. However, this is not maintained - by the early 2000s, after the technology bubble had burst, there is a period when all eleven markets run broadly in parallel, until the credit crunch introduces some dispersion. It is quite striking about how badly Italy has fared in the post credit-crunch period. Whilst the other markets appear from the chart to have stayed quite tightly bunched, the longer-term performance ranges from 11.6% p.a. for Switzerland through to 8.6% p.a. for the UK so there is still some dispersion (much of it from currency effects). In part, this general bunching may be a reminder of the increasing globalisation of markets and the weakening of the linkage between a country's equity market and its actual economy. The travails of the Japanese equity market are well known, but it is sobering to note that even after its recent rally, this only gets the annualised sterling total return since January 1988 back up to just above zero (0.2% p.a. for those who are curious).



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 2014

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	-1.6	0.6	1.2	11.1	8.7	7.6	7.8
Overseas Equities	-1.4	4.9	12.2	15.1	10.7	9.3	7.7
US Equities	0.1	8.9	20.3	20.4	16.2	10.2	8.3
Europe ex UK Equities	-5.2	-1.4	-1.4	12.8	5.4	7.5	9.9
Japan Equities	-0.8	1.6	2.7	9.9	6.6	4.5	0.2
Pacific ex Japan Equities	-1.6	3.2	10.0	9.4	6.7	12.1	6.9
Emerging Markets	-4.1	-0.6	4.3	4.3	2.8	11.1	6.0
UK Long-dated Gilts	3.4	11.2	26.1	6.9	10.9	7.5	8.8
UK Long-dated Corp. Bonds	2.2	6.6	19.0	10.2	10.4	6.9	-
UK Over 5 Yrs Index-Linked Gilts	1.7	9.4	21.4	7.1	10.5	8.2	8.3
High Yield (Global)	-1.9	1.5	6.1	8.6	9.3	9.9	-
Overseas Bonds	0.0	2.8	6.4	-1.4	2.5	5.5	5.4
Property *	1.3	4.5	19.9	10.2	11.3	5.8	8.4
Cash	0.0	0.1	0.5	0.6	0.7	2.6	4.1
Commodities £-converted	-13.2	-24.8	-28.9	-13.0	-5.9	-2.8	1.9
Hedge Funds original \$ basis *	0.8	-0.5	4.3	6.1	4.9	5.3	8.8
Illustrative £-converted version *	3.0	5.5	9.1	6.2	5.9	7.4	8.8
Euro relative to Sterling	-2.6	-0.5	-6.7	-2.4	-2.7	0.9	-
US \$ relative to Sterling	0.4	4.0	6.2	-0.1	0.7	2.1	0.0
Japanese Yen relative to Sterling	-0.6	-4.9	-6.9	-13.8	-4.3	0.5	-0.9
Sterling trade weighted	1.3	-0.6	3.3	2.7	1.7	-1.3	0.1
Price Inflation (RPI) *	-0.2	0.0	2.0	2.5	3.5	3.1	2.9
Price Inflation (CPI) *	-0.2	-0.1	0.9	1.9	2.7	2.7	2.1
Price Inflation (RPIX) *	-0.2	0.0	2.0	2.6	3.5	3.3	2.9
Earnings Inflation **	-0.1	-0.1	1.9	1.4	1.7	2.5	3.3
All Share Capital Growth	-1.7	0.0	-2.1	7.3	5.1	3.9	4.3
Net Dividend Growth	0.1	0.9	0.6	5.8	6.1	4.9	-
Earnings Growth	-0.1	-11.1	-7.9	-6.1	9.0	3.8	4.8

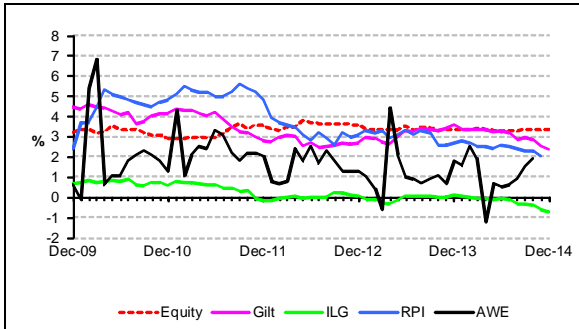
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

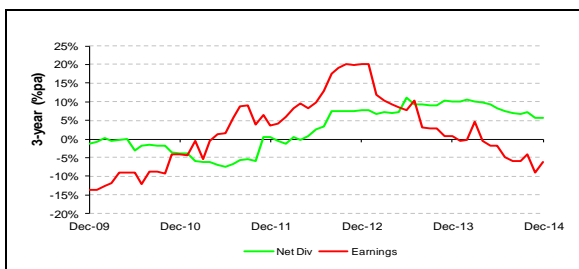
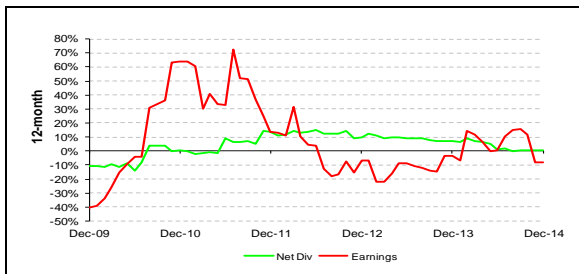


The gap gives a current expectation now around 3.1% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

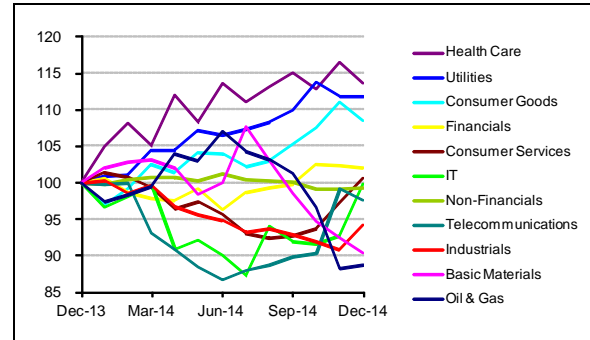
Figure 3: Dividend & Earnings Growth



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



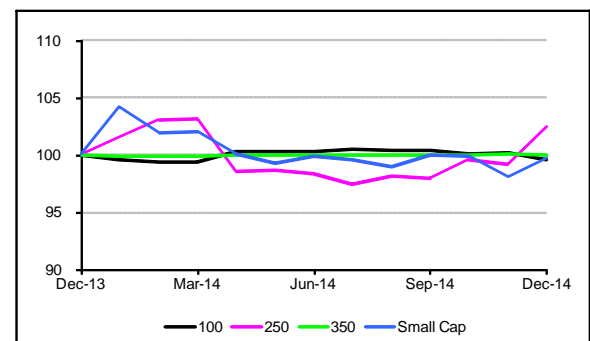
Note: Sector labels for relative lines are in end-value order

There was a small fall this month in the rolling 12-month sector dispersion (from 26% to 25%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-1.1	-11.9	-10.2
Basic Materials	-3.8	-7.8	-8.7
Industrials	2.2	2.1	-4.7
Consumer Goods	-4.0	3.6	9.7
Health Care	-4.1	-0.7	14.9
Consumer Services	1.8	9.1	1.8
Telecommunications	-3.3	9.2	-1.4
Utilities	-1.5	2.4	13.2
Non-Financials	-1.5	-0.2	0.5
Financials	-1.9	2.8	3.2
IT	5.8	9.1	0.9
All Share	-1.6	0.6	1.2

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



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

FRS17 volatility indicator

Now discontinued, but available on request.



Bond market information

Figure 5: £ Non-Gilt Credit Margins

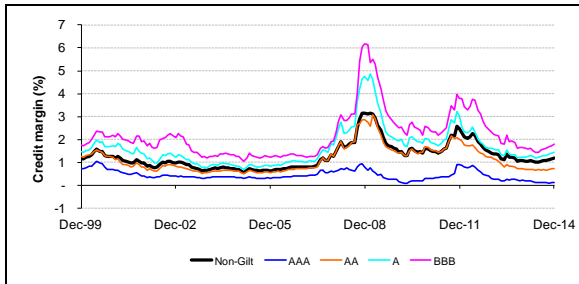


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jul '14	4.04	3.21	0.83
Aug '14	3.70	2.86	0.84
Sep '14	3.80	2.95	0.85
Oct '14	3.76	2.85	0.91
Nov '14	3.53	2.55	0.98
Dec '14	3.38	2.38	1.00

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

Category	Mkt Val @ Dec 14 & 11, 08			Weight (%)
	Dec 14	Dec 11	08	
Gilts (39)	1,226	999	502	68.7
Non Gilts (1,056)	560	472	419	31.3
AAA (128)	106	129	161	6.0
AA (182)	94	68	73	5.3
A (356)	181	168	121	10.1
BBB (390)	178	107	62	10.0

Category	Mkt Val @ Dec 14, & 11		W't (%)	Dur'n (yrs)
Gilts (39)	1,226	999	68.7	10.5
< 5 Yrs (11)	338	279	18.9	2.8
5-15 Yrs (12)	383	324	21.5	7.2
> 15 Yrs (16)	505	396	28.3	18.1
Non Gilts (1,056)	560	472	31.3	8.2
< 5 Yrs (340)	159	124	8.9	2.6
5-15 Yrs (451)	239	200	13.4	7.7
> 15 Yrs (265)	162	148	9.1	14.4

£ Gilt Market “main” Issuance

- o £3.75bn 2% 2020 (1.50x, 1.46%, Oct 14)
 - o £1.92bn 3½% 2045 (1.84x, 2.70%, Oct 14)
 - o £0.81bn ILG ¾% 2034 (2.43x, r.y -0.76%, Apr 14)
- Note: Issuance amounts are nominals.

Tables 2d, 2e: € Market Size and Maturity (Dec 14)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (310)	5,523	60.6
Non Sovereigns	3,594	39.4
AAA (568)	1,069	11.7
AA (486)	837	9.2
A (784)	858	9.4
BBB (828)	830	9.1

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (806)	2,196	24.1
3 – 5 Yrs (715)	1,855	20.3
5 – 7 Yrs (641)	1,570	17.2
7 – 10 Yrs (533)	1,655	18.2
10+ Yrs (281)	1,842	20.2

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Dec 14 & 11)		W't (%)	Dur'n (yrs)
Gilts (24)	478	334	92.8	20.3
< 5 Yrs (3)	52	49	10.2	-
5 – 15 Yrs (6)	130	87	25.3	-
> 15 Yrs (15)	295	197	57.3	28.4
Non Gilts (43)	37	29	7.2	17.2

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

Month End	US (%)	Euro (%)	Sterling (%)
Jun '14	5.16	3.91	5.51
Jul '14	5.55	4.04	5.72
Aug '14	5.32	3.94	5.63
Sep '14	5.80	4.05	5.87
Oct '14	5.59	4.08	6.27
Nov '14	5.83	3.91	6.19
Dec '14	6.16	4.00	6.15

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

