



Investment Update December 2015

Investment Headlines & Comment

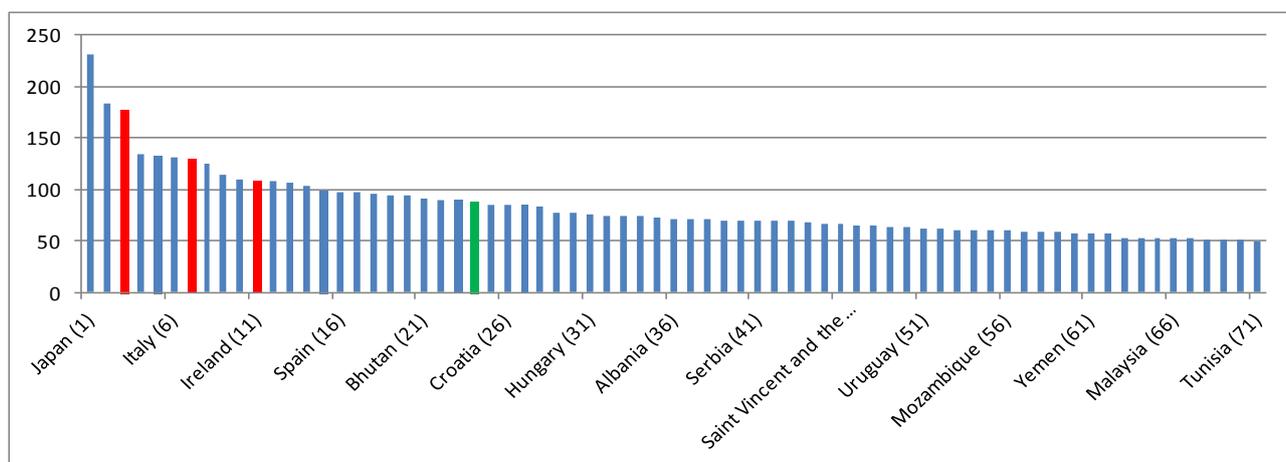
- **US interest rates** nudged up (finally) from 0.25% to 0.50%, and the US Dollar strengthened.
- **The Netherlands** have regained their AAA rating, two years after they lost it.
- **The UK Equity market weighting** hits a new low of 6.92% within the FT All-World classification.

Feature Section This month we revisit the public debt ratios we last considered in our [April 2011](#) issue, to see how things have progressed. The data is once again from the World Factbook of the Central Intelligence Agency, but relates to 2014 data (due to publication lags).

Figure 1 below shows a selection of ratios from the CIA World Factbook, in descending order (the bracketed number is the country's ranking), but the data reliability has to be questioned in some cases¹, and it is only for public debt, not corporate debt as well. We have cut off the (very long) tail of values below 50% - this thus excludes European countries such as the Czech Republic, Denmark, Norway, Switzerland, and further afield, Australia and New Zealand.

Figure 1: Public debt to GDP ratios (%)

Source: CIA World Factbook



It is worth pointing out that there is no single ‘magic’ constant % as to what level is sustainable for this ratio – academic studies have conflicted on this subject, but it does at least seem clear that it is a function of various factors including a country’s individual reputation (= past reliability on repayments), whether it is developed or developing, and the balance between domestic and external debtholders (with Japan being a prime example of this).

It is interesting to note that Japan continues to have the highest ratio, with virtually no change from its 2010 position. The three red bars are Greece (#3, 177%), Portugal (#7, 130%) and Ireland (#11, 108%) – all three have markedly higher rankings and figures than in 2010. France and Spain have figures in the mid 90s. All five are well above the Euro’s original 60% qualification level. The level is supposedly an ongoing criterion as well (in theory, at least – Hamlet’s phrase “more honoured in the breach than the observance” seems apt).

A few countries have seen material drops in their ratio figures over the last 4 years (e.g. Iceland down by 38%), but rather more have seen increases, although for most European nations, including the UK, the increases are in the 10%-15% range – exceptions are Spain and Portugal with rises of 34% and 47% respectively. Another notable outlier on the increases is Canada, with a rise in their ratio figure by 61%.

The green bar is the UK (#24, 88% - this is a “pre bank interventions” figure, now higher than the US and Germany, both on 74%, but our debt profile is much longer dated, which arguably helps smooth the impact of refinancing the debt). It remains to be seen whether the current Government’s spending plans enable the rate to fall.

¹ To put this comment in context for a non-Eurozone example, the US data excludes debt issued by individual US states, as well as intra-governmental debt – this aspect of US debt consists of Treasury borrowings from surpluses in the trusts for Federal Social Security, Federal Employees, Hospital Insurance (Medicare and Medicaid), Disability and Unemployment, and several other smaller trusts; if data for intra-government debt were added, the [CIA](#) states that "Gross Debt" would increase by about a third of GDP. So, that would not be a negligible adjustment, but probably not enough to change the overall picture.



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 2015

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	-1.3	4.0	1.0	7.3	6.0	5.6	6.7
Overseas Equities	0.5	8.4	4.4	12.4	8.2	7.3	6.9
US Equities	0.4	9.6	6.9	18.8	13.8	9.0	7.5
Europe ex UK Equities	0.0	5.9	5.5	8.9	5.2	5.7	8.5
Japan Equities	2.4	12.5	17.6	14.7	6.3	2.7	1.0
Pacific ex Japan Equities	2.7	8.4	-3.5	2.5	1.5	8.4	5.9
Emerging Markets	-0.1	3.5	-9.7	-3.3	-3.3	5.6	6.0
UK Long-dated Gilts	-2.0	-2.4	0.1	5.9	9.1	6.4	8.0
UK Long-dated Corp. Bonds	-1.8	0.5	-1.3	5.3	8.1	5.5	-
UK Over 5 Yrs Index-Linked Gilts	-3.4	-3.3	-1.2	6.4	8.4	7.1	7.6
High Yield (Global)	0.0	1.5	1.4	4.5	6.1	8.7	-
Overseas Bonds	3.3	1.8	3.2	0.9	1.3	5.4	4.6
Property *	0.9	3.2	14.3	14.3	10.7	5.5	8.9
Cash	0.0	0.1	0.6	0.5	0.7	2.2	3.8
Commodities £-converted	-6.7	-14.4	-29.0	-21.2	-14.1	-9.2	-0.8
Hedge Funds original \$ basis *	0.2	0.5	-0.2	4.5	3.1	4.4	7.8
Illustrative £-converted version *	2.7	2.6	3.8	6.7	3.8	5.8	7.9
Euro relative to Sterling	5.0	-0.1	-5.0	-3.1	-3.0	0.7	-
US \$ relative to Sterling	2.1	2.7	5.8	3.3	1.2	1.5	0.3
Japanese Yen relative to Sterling	4.7	2.2	5.4	-7.5	-6.5	1.3	-0.5
Sterling trade weighted	-3.1	-0.5	3.0	2.6	2.5	-0.8	0.6
Price Inflation (RPI) *	0.1	0.0	1.1	1.9	2.8	3.0	2.8
Price Inflation (CPI) *	-0.1	-0.1	0.1	1.0	2.1	2.5	2.0
Price Inflation (RPIX) *	0.1	0.0	1.1	1.9	2.8	3.2	2.8
Earnings Inflation **	-0.1	-1.8	1.8	1.6	1.6	2.3	3.2
All Share Capital Growth	-1.4	3.2	-2.5	3.6	2.4	1.9	3.3
Net Dividend Growth	0.5	3.0	7.0	4.9	7.6	4.3	-
Earnings Growth	-0.3	-1.0	-13.6	-8.4	-4.1	0.1	2.9

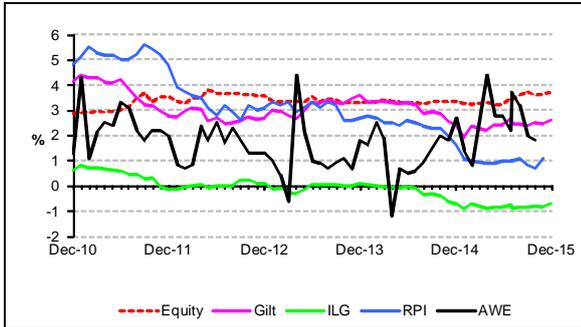
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

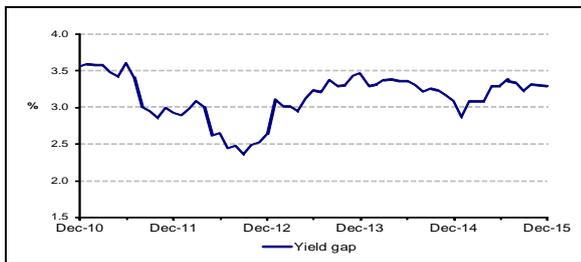


Yields and Yield Gaps

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.

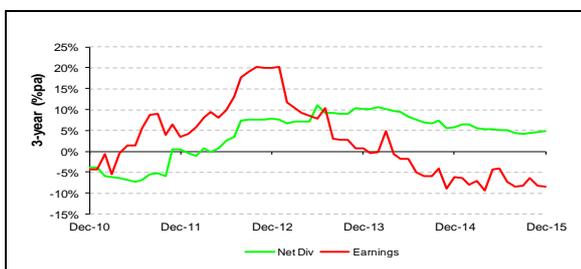
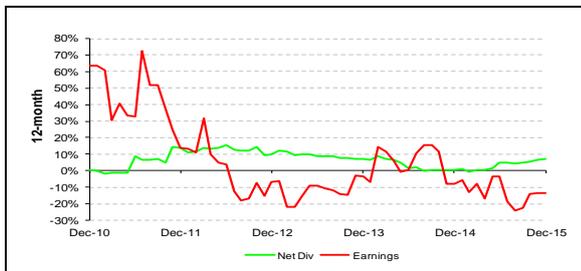


The gap gives a current expectation around 3.3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

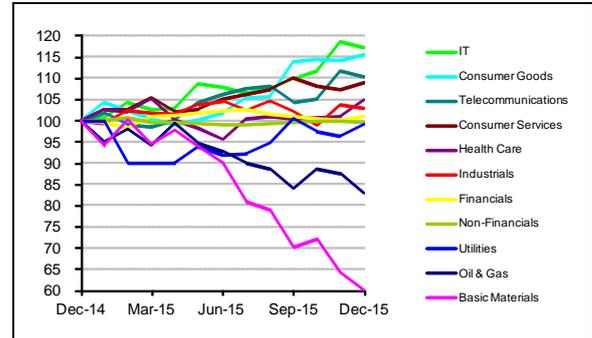
Figure 3: Dividend & Earnings Growth



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



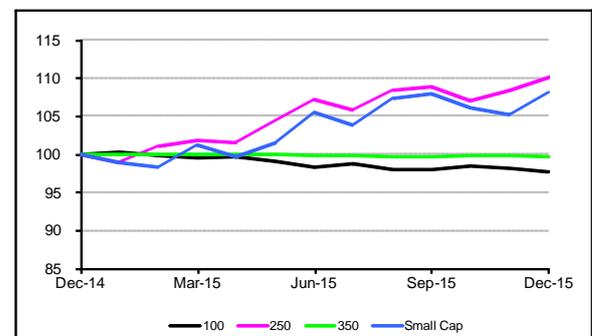
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 65% to 57%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-6.7	2.3	-16.5
Basic Materials	-7.4	-11.1	-39.3
Industrials	-1.9	4.9	4.0
Consumer Goods	0.0	5.5	16.8
Health Care	2.4	8.4	5.9
Consumer Services	0.2	2.9	10.0
Telecommunications	-2.3	10.1	11.6
Utilities	1.5	2.4	-0.1
Non-Financials	-1.5	4.0	0.7
Financials	-0.6	3.8	1.9
IT	-2.3	11.0	18.5
All Share	-1.3	4.0	1.0

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap 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

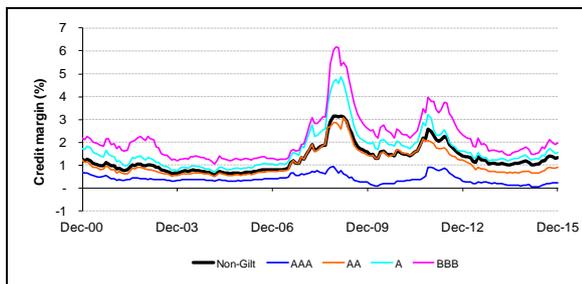


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jul '15	3.45	2.49	0.96
Aug '15	3.61	2.49	1.12
Sep '15	3.59	2.39	1.20
Oct '15	3.66	2.53	1.13
Nov '15	3.49	2.47	1.02
Dec '15	3.65	2.59	1.06

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

Category	Mkt Val @ Dec 15 & 12, 09			Weight (%)
	Dec 15	Dec 12	09	
Gilts (39)	1,211	1,112	693	69.7
Non Gilts (1,034)	525	533	461	30.3
AAA (127)	100	135	139	5.8
AA (186)	91	74	60	5.3
A (332)	155	177	163	8.9
BBB (389)	179	147	95	10.3

Category	Mkt Val @ Dec 15 & 12		W't (%)	Dur'n (yrs)
	Dec 15	Dec 12		
Gilts (39)	1,211	1,112	69.7	10.5
< 5 Yrs (11)	350	309	20.1	2.9
5-15 Yrs (11)	334	360	19.2	7.1
> 15 Yrs (17)	528	443	30.4	17.7
Non Gilts (1,034)	525	533	30.3	7.8
< 5 Yrs (348)	156	146	9.0	2.5
5-15 Yrs (443)	225	216	13.0	7.5
> 15 Yrs (243)	144	170	8.3	14.2

£ Gilt Market "main" Issuance

- £3.75bn 1½% 2021 (1.37x, 1.26%, Oct 15)
 - £2.20bn 3½% 2045 (1.38x, 2.49%, Sep 15)
 - £0.70bn 1¼% IL 2032 (1.86x, ry -0.72%, Dec 11)
 - £3.25bn 1/8% IL 2046 (4.00x, ry -0.75%, Jun 15)
- Note: Issuance amounts are nominals.

Tables 2d, 2e: € Market Size and Maturity (Dec 15)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (319)	5,681	61.2
Non Sovereigns	3,597	38.8
AAA (628)	1,036	11.2
AA (588)	946	10.2
A (774)	783	8.4
BBB (928)	832	9.0

Category	Mkt Val (€bn)	Weight (%)
1 - 3 Yrs (781)	2,088	22.5
3 - 5 Yrs (798)	2,025	21.8
5 - 7 Yrs (726)	1,600	17.2
7 - 10 Yrs (615)	1,690	18.2
10+ Yrs (317)	1,874	20.2

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Dec 15 & 12)	W't (%)	Dur'n (yrs)
Gilts (25)	476 340	93.3	21.5
< 5 Yrs (3)	49 45	9.6	-
5 - 15 Yrs (7)	123 97	24.2	-
> 15 Yrs (15)	304 198	59.5	29.2
Non Gilts (37)	34 30	6.7	17.0

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

Month End	US (%)	Euro (%)	Sterling (%)
Jun '15	6.10	4.23	6.11
Jul '15	6.20	4.08	6.06
Aug '15	6.61	4.43	6.38
Sep '15	7.21	5.14	6.58
Oct '15	6.68	4.52	6.40
Nov '15	7.03	4.37	6.30
Dec '15	7.51	5.13	6.51

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

