



## Investment Update

April 2015

### Investment Headlines & Comment

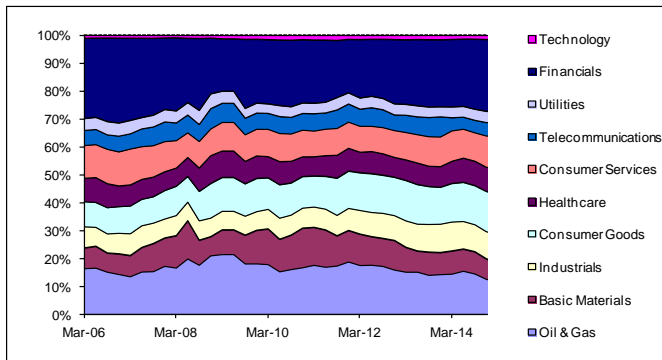
- The volatility in **gilt markets** continued, with a poor month as yields rose slightly.
- **Sterling** rallied against both the US Dollar and the Japanese Yen, but was pretty flat against the Euro.
- UK-listed **Oil & Gas stocks** returned almost 9% this month, but remain very volatile.

### Feature Section

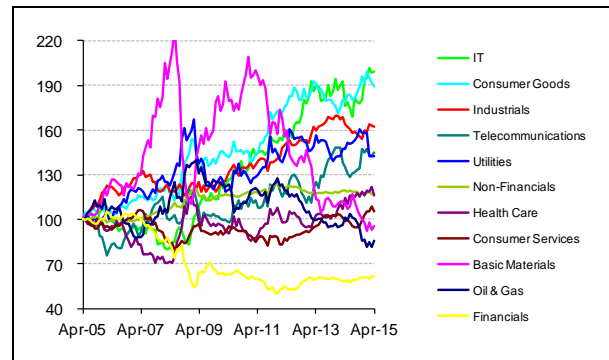
This month we look at the evolution of the All Share index sector weightings over the period since early 2006 when the current broad categorization labels were introduced. This item is prompted by the fall in the Oil price, and a desire to investigate its impact on the weighting for the Oil & Gas sector.

Figure 1a shows that the Oil & Gas sector started at a weight of 17% but rose to 22% during the depths of the credit crunch in early 2009, before decaying to its current level of 12%. Basic Materials has also seen a significant decline in its weighting from its peak value of 14% at the end of 2010. These can be contrasted with the Financials sector, which Figure 1a shows started at a weight of 29% but fell to 17% at the depth of the credit crunch in early 2009, before recovering to its current level of 26%. Over the period shown in Figure 1a, there has been very little change in the weightings for IT and Utilities, and below 4% variation in each of the weights for Healthcare, Consumer Services and Telecommunications.

**Figure 1a: Quarterly Sector weightings**



**Figure 1b: Dispersion of returns vs All Share**



Source: FT Note: Labels in Figure 1b are in end-value order

Figure 1b shows the cumulative total returns for the various sectors, relative to the All Share being fixed at 100. The sharpness of the turns on some of the lines, particularly Basic Materials, acts as a reminder of just how significant an effect sector selection can have on UK equity returns. Also, the cumulative dispersion is pretty striking – IT ends up 100% ahead of the All Share (in geometric terms) over the 10 years, whereas Financials end up 39% behind. These are unannualised, but even if you annualise then, you still come out with material divergences of 7% p.a. ahead and minus 5% p.a. behind, respectively.

If you look at the weightings in the (market cap based) FTSE All World index, you find that even with the decline in the UK's Oil & Gas and Basic Materials sector weightings, Oil & Gas remains the biggest overweight for UK sectors relative to their World counterparts, followed by Basic Materials. These together offset most of the UK's marked underweighting in Technology relative to the World weighting.

We touched on some of these relative weightings in our [June 2013](#) edition, which considered the degree of correlation between UK Equities and various overseas regions. Over the 5 years to the end of April 2015, using monthly FT All World data, the updated correlations are World ex-UK 85%, Europe ex-UK 90%, USA 70%, Japan 29% (which is probably distorted by the volatility of the currency), and Pacific ex Japan 70%. A simple 3-way split between USA, Europe ex UK, and Asia gives a correlation of 86%. This high figure, and indeed the high figure for World ex-UK, acts as a reminder that you do not automatically get much diversification by investing overseas, although it is fair to note that the rolling correlations have fallen over the last couple of years (particularly for Japan which had been at a correlation of over 60%).



**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 April 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	3.0	5.1	7.5	11.9	9.3	8.3	7.9
Overseas Equities	-0.8	4.7	20.0	15.4	10.2	10.3	7.8
US Equities	-2.5	2.8	24.0	<b>19.0</b>	<b>14.2</b>	11.0	8.5
Europe ex UK Equities	0.3	6.8	6.9	15.3	7.6	8.9	<b>9.6</b>
Japan Equities	-0.1	<b>9.2</b>	<b>32.1</b>	14.5	7.0	6.5	<b>1.0</b>
Pacific ex Japan Equities	2.3	6.2	23.0	10.7	7.1	<b>13.3</b>	7.5
Emerging Markets	<b>4.1</b>	7.0	18.9	5.5	3.3	12.3	7.3
UK Long-dated Gilts	<b>-3.8</b>	<b>-8.0</b>	20.6	8.3	10.7	7.4	8.6
UK Long-dated Corp. Bonds	-3.4	-6.7	15.5	10.5	9.8	6.8	-
UK Over 5 Yrs Index-Linked Gilts	-0.9	-2.4	18.8	8.8	10.6	8.3	8.2
High Yield (Global)	-1.0	1.5	8.7	9.0	7.7	10.6	-
Overseas Bonds	-2.7	-3.5	5.0	<b>0.1</b>	1.7	5.6	5.0
Property *	1.3	3.0	18.3	11.4	10.3	5.9	8.6
Cash	0.0	0.1	<b>0.6</b>	0.6	<b>0.7</b>	<b>2.4</b>	4.0
Commodities £-converted	7.3	7.7	<b>-27.7</b>	<b>-12.2</b>	<b>-6.4</b>	<b>-3.5</b>	2.1
Hedge Funds original \$ basis *	0.4	2.2	4.1	5.3	4.5	5.3	8.8
Illustrative £-converted version *	4.4	7.3	16.9	7.9	5.0	7.8	9.3
Euro relative to Sterling	0.8	-2.9	-11.2	-3.6	-3.4	0.8	-
US \$ relative to Sterling	-3.4	-2.3	9.9	1.9	-0.1	2.2	0.2
Japanese Yen relative to Sterling	-3.2	-4.1	-6.2	-11.0	-4.8	0.9	-1.5
Sterling trade weighted	2.1	2.9	5.1	3.0	2.7	<b>-1.2</b>	0.5
Price Inflation (RPI) *	0.2	-0.2	0.9	2.2	3.1	3.0	2.8
Price Inflation (CPI) *	0.2	-0.5	-0.1	1.5	2.4	2.5	2.0
Price Inflation (RPIX) *	0.2	-0.2	0.9	2.2	3.1	3.2	2.8
Earnings Inflation **	4.4	8.0	0.8	1.2	1.1	2.3	3.5
All Share Capital Growth	2.6	3.8	3.9	8.0	5.6	4.6	4.4
Net Dividend Growth	-0.4	1.9	0.2	5.4	5.5	4.7	-
Earnings Growth	<b>-8.3</b>	<b>-5.4</b>	<b>-16.9</b>	<b>-9.5</b>	2.8	2.7	3.9

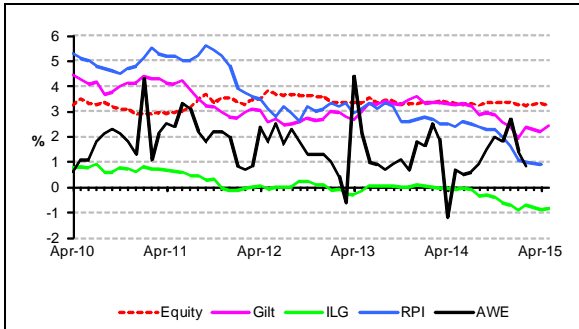
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

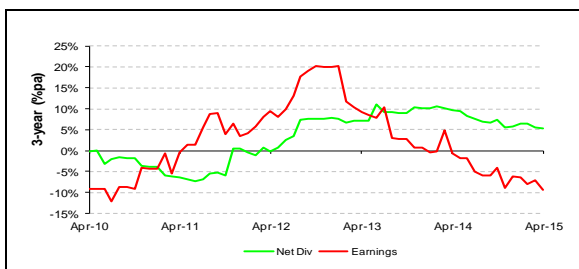
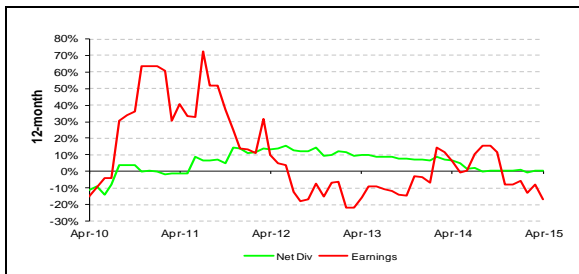


The gap gives a current expectation now clearly above 3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

## 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]

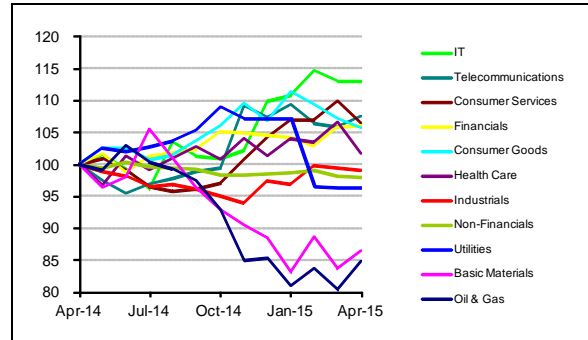
Figure 3: Dividend & Earnings Growth



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



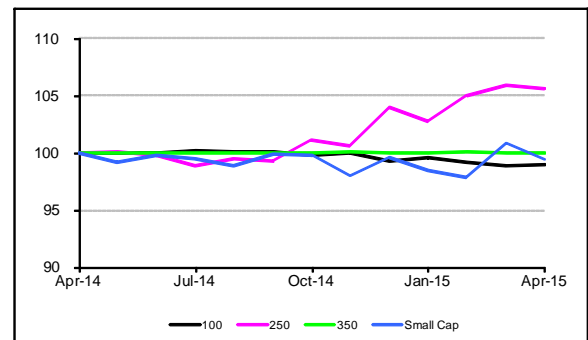
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 31% to 28%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	8.9	10.1	-8.8
Basic Materials	6.5	9.2	-7.2
Industrials	2.8	7.4	6.5
Consumer Goods	1.6	-0.3	13.7
Health Care	-1.8	2.6	9.2
Consumer Services	-0.2	4.6	14.5
Telecommunications	4.6	3.2	15.6
Utilities	3.0	-5.6	3.5
Non-Financials	3.0	4.5	5.4
Financials	3.2	6.9	13.9
IT	3.1	7.2	21.5
All Share	3.0	5.1	7.5

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



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

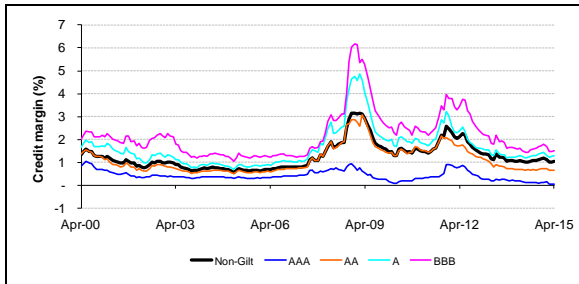
## FRS17 volatility indicator

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 (%)
Nov '14	3.53	2.55	0.98
Dec '14	3.38	2.38	1.00
Jan '15	2.82	1.93	0.89
Feb '15	3.22	2.37	0.85
Mar '15	3.08	2.20	0.88
Apr '15	<b>3.30</b>	<b>2.44</b>	<b>0.86</b>

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

Category	Mkt Val @ Apr 15 & 12, 09			Weight (%)
	1,198	990	596	
Gilts (38)	1,198	990	596	68.8
Non Gilts (1,029)	543	481	404	31.2
AAA (119)	99	124	144	5.7
AA (183)	93	61	54	5.4
A (354)	177	169	136	10.2
BBB (373)	174	127	68	10.0

Category	Mkt Val @ Apr 15, & 12		W't (%)	Dur'n (yrs)
Gilts (38)	1,198	990	68.8	10.6
< 5 Yrs (10)	328	271	18.9	3.0
5-15 Yrs (12)	358	327	20.5	7.2
> 15 Yrs (16)	512	393	29.4	17.9
Non Gilts (1,029)	543	481	31.2	8.2
< 5 Yrs (345)	158	124	9.0	2.7
5-15 Yrs (433)	229	209	13.2	7.7
> 15 Yrs (251)	156	148	9.0	14.5

**£ Gilt Market “main” Issuance**

- o £4.01bn 2% 2020 (1.19x, 1.18%, Mar 15)
- o £3.00bn 2% 2025 (1.54x, 1.88%, Mar 15)
- o £1.92bn 3½% 2045 (1.43x, 2.34%, Feb 15)
- o £1.28bn 5/8% IL 2040 (1.38x, -0.97%, Aug 14)

Note: Issuance amounts are nominals.

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (325)	5,757	61.4
Non Sovereigns	3,627	38.6
AAA (558)	1,023	10.9
AA (535)	916	9.8
A (788)	840	8.9
BBB (866)	848	9.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (797)	2,177	23.2
3 – 5 Yrs (704)	1,841	19.6
5 – 7 Yrs (670)	1,625	17.3
7 – 10 Yrs (574)	1,700	18.1
10+ Yrs (327)	2,039	21.7

**Table 2f: Breakdown of £ Index-Linked Market**

Category (Number of issues)	Mkt Val (£bn @ Apr 15 & 12)		W't (%)	Dur'n (yrs)
Gilts (24)	499	338	93.2	20.7
< 5 Yrs (4)	76	49	14.2	-
5 – 15 Yrs (5)	106	87	19.9	-
> 15 Yrs (15)	316	201	59.1	28.6
Non Gilts (40)	36	28	6.8	17.3

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

Month End	US (%)	Euro (%)	Sterling (%)
Oct '14	5.59	4.08	6.27
Nov '14	5.83	3.91	6.19
Dec '14	6.16	4.00	6.15
Jan '15	6.07	3.81	5.83
Feb '15	5.72	3.63	5.84
Mar '15	5.90	3.77	5.86
Apr '15	<b>5.72</b>	<b>3.74</b>	<b>5.84</b>

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

