



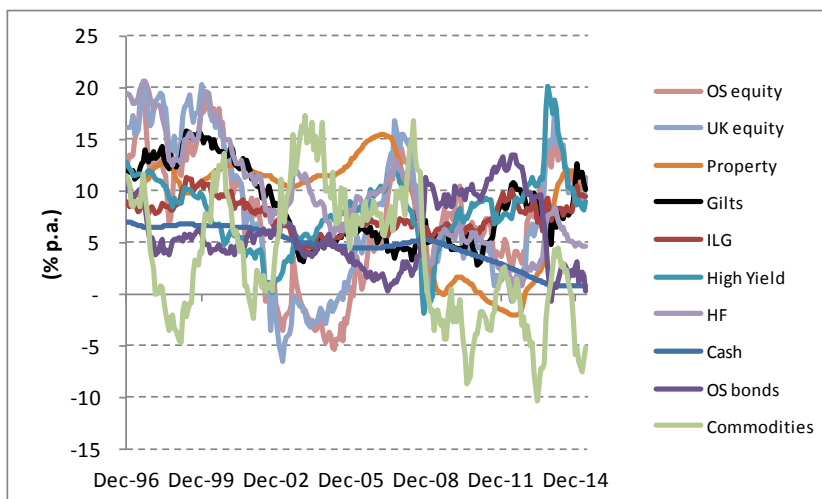
Investment Headlines & Comment

- An unexpected UK election result but no significant moves in the main UK asset classes resulted.
- **CPI inflation** has turned slightly negative, but it looks likely to be a short-term effect.
- **European long-dated yields** up from end-March lows, but the 30-year German yield is only 1.1%.

Feature Section

This month we look at trends in volatility for the main asset classes used by institutional investors, and how that reflects the general background against which investment returns were produced. The data sources are broadly as per Table 1 of our monthly Update. Figure 1a shows rolling 5-year returns since December 1996 (with the start date being determined simply by the available 1991 start date for one data source). Figure 1b shows rolling 5-year volatility since the same point, using monthly data. The chart labels are in end-value order for ease of use.

Figure 1a: 5-year returns



The dispersion of returns across asset classes is pretty wide in Figure 1a, with an average gap of 14% p.a. between best and worst, so the opportunities from asset allocation have been considerable (and by extension, so have the risks).

It is noticeable that Commodities have often been ranked as the best or the worst – if we had extended the assets set to include Emerging Markets, they could well have been just as variable. However, if you exclude Commodities, there have rarely been prolonged periods of negative returns for other asset classes – UK and Overseas Equities went negative in the early 2000s off the back of the tech bubble bursting, and Property had a modest negative period in the early 2010s. The impact of the prolonged falls in bond yields is clear. Gilts are currently ranked fourth in a close group – see our [March 2015](#) edition for background.

Figure 1b: 5-year volatility

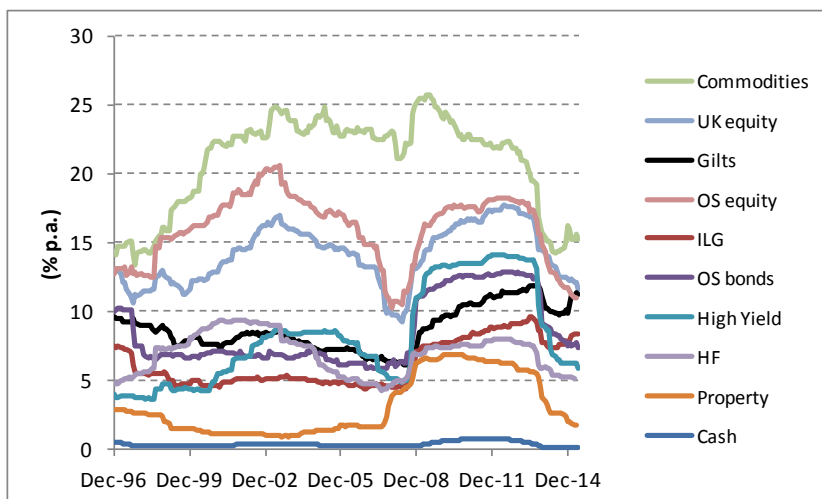


Figure 1b shows that volatility has had periods of stability for some asset classes, but not for all. Property is getting back towards the unusually low volatility levels seen in the pre-credit crunch era. The pattern has been similar for UK and Overseas Equities, as might have been expected. Both Gilts and Index-Linked Gilts are at levels of volatility well above those seen in the early 2000s, but it is questionable whether their current volatility levels should be adopted in asset-liability models.

Sources: As per Table 1, other than using a US High Yield index to get a longer back-history than Table 1's Global index, and all-dated ILGs instead of Over 5 Yr.

The “jump” points in Figure 1b mark major events entering or leaving the rolling 5-year period. For example, in the mid to late 1990s, the (temporary) downward spike in bond yields drops out, and then in late 2008, the “credit crunch” shock enters, leaving in late 2013. Quite what the next major event will be is anyone’s guess from a long list of known candidates, and probably some as yet hidden ones too.



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 May 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	1.4	2.7	7.5	15.1	11.0	8.0	7.8
Overseas Equities	0.7	2.8	17.2	17.1	11.4	9.6	7.7
US Equities	2.0	2.0	22.8	20.1	15.5	10.3	8.3
Europe ex UK Equities	-0.3	2.9	4.1	18.5	9.3	8.2	9.4
Japan Equities	2.2	8.2	28.7	16.8	8.1	6.3	1.3
Pacific ex Japan Equities	-1.7	4.3	16.3	12.1	8.0	12.4	7.0
Emerging Markets	-3.3	3.2	10.3	6.6	3.4	11.0	6.9
UK Long-dated Gilts	0.6	0.1	19.5	5.9	10.2	7.3	8.4
UK Long-dated Corp. Bonds	0.4	-1.2	13.7	9.2	9.8	6.6	-
UK Over 5 Yrs Index-Linked Gilts	0.4	3.7	17.7	7.6	10.7	8.3	8.0
High Yield (Global)	0.7	2.7	7.9	8.3	7.8	10.1	-
Overseas Bonds	-1.6	-1.0	2.1	-2.2	0.3	5.1	4.7
Property *	1.0	3.2	17.9	11.7	10.2	5.8	8.6
Cash	0.0	0.1	0.6	0.6	0.7	2.4	4.0
Commodities £-converted	-1.3	2.7	-29.0	-10.1	-5.2	-4.0	2.0
Hedge Funds original \$ basis *	0.9	3.2	5.3	5.8	4.5	5.5	8.7
Illustrative £-converted version *	-2.5	0.9	15.7	7.8	4.4	7.8	8.9
Euro relative to Sterling	-1.5	-1.0	-11.7	-3.7	-3.2	0.6	-
US \$ relative to Sterling	0.7	1.2	9.9	0.3	-1.0	1.8	0.2
Japanese Yen relative to Sterling	-2.9	-2.4	-9.9	-13.9	-6.9	0.4	-1.7
Sterling trade weighted	0.6	0.8	5.8	3.4	2.9	-0.9	0.6
Price Inflation (RPI) *	0.4	1.0	0.9	2.1	3.0	3.0	2.8
Price Inflation (CPI) *	0.3	0.7	-0.1	1.4	2.3	2.5	2.0
Price Inflation (RPIX) *	0.4	1.1	0.9	2.1	3.0	3.2	2.8
Earnings Inflation **	6.4	10.0	3.2	1.5	1.5	2.8	3.7
All Share Capital Growth	1.0	1.4	3.9	11.2	7.3	4.3	4.3
Net Dividend Growth	1.6	2.4	1.7	5.4	5.6	4.5	-
Earnings Growth	13.1	6.2	-3.3	-4.3	4.2	3.7	4.4

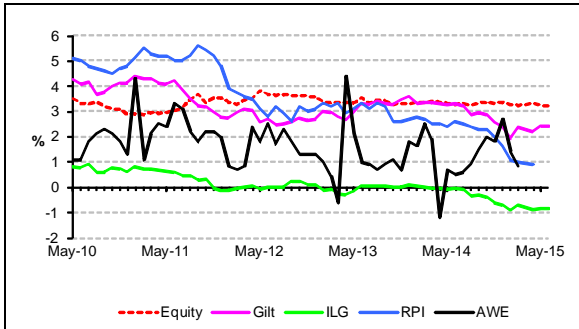
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

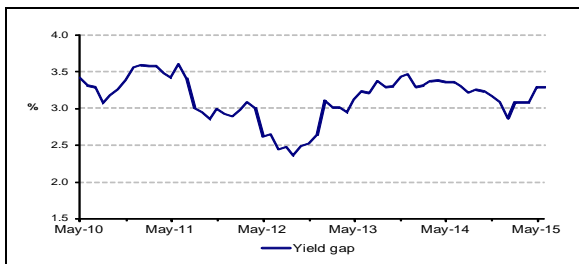


Yields and Yield Gaps

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.

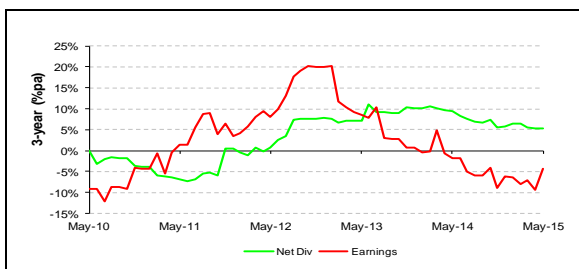
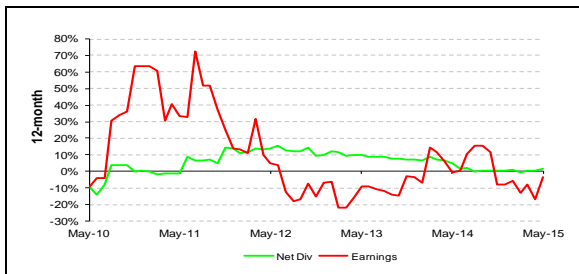


The gap gives a current expectation now clearly above 3% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

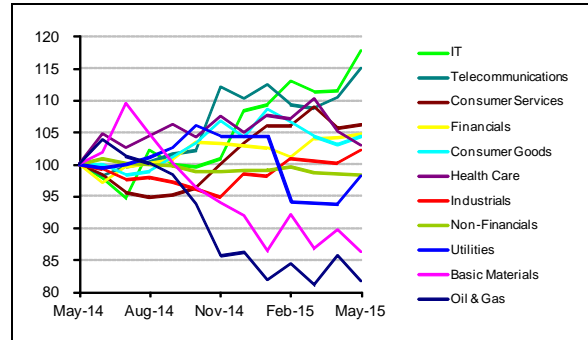
Figure 3: Dividend & Earnings Growth



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



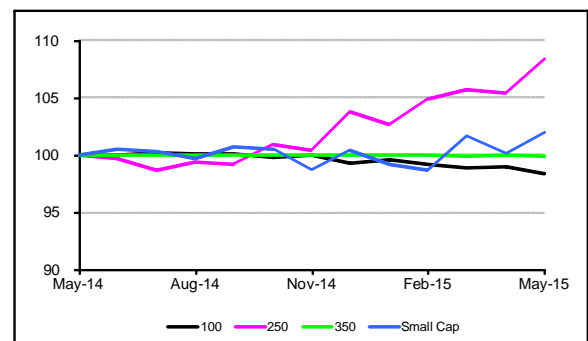
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (from 28% to 36%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-3.5	-0.8	-12.3
Basic Materials	-2.6	-3.9	-7.3
Industrials	3.3	4.0	9.9
Consumer Goods	2.7	0.6	12.3
Health Care	-0.6	-1.2	10.7
Consumer Services	2.0	2.8	14.2
Telecommunications	5.6	8.0	23.7
Utilities	5.9	7.1	5.4
Non-Financials	1.2	1.5	5.8
Financials	1.8	6.3	12.6
IT	7.1	7.0	26.6
All Share	1.4	2.7	7.5

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

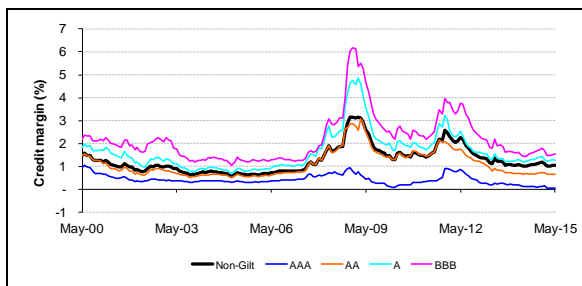


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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	3.30	2.44	0.86
May '15	3.30	2.43	0.87

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

Category	Mkt Val @ May 15 & 12, 09			Weight (%)
	1,210	1,052	602	
Gilts (38)	1,210	1,052	602	68.9
Non Gilts (1,034)	547	494	422	31.1
AAA (119)	100	132	145	5.7
AA (185)	95	619	57	5.4
A (357)	178	173	144	10.1
BBB (373)	174	128	74	9.9

Category	Mkt Val @ May 15, & 12		W't (%)	Dur'n (yrs)
Gilts (38)	1,210	1,052	68.9	10.7
< 5 Yrs (10)	329	274	18.7	2.9
5-15 Yrs (12)	363	349	20.7	7.2
> 15 Yrs (16)	518	430	29.5	18.0
Non Gilts (1,034)	547	494	31.1	8.2
< 5 Yrs (349)	160	128	9.1	2.7
5-15 Yrs (436)	231	211	13.2	7.7
> 15 Yrs (249)	156	155	8.9	14.5

£ Gilt Market “main” Issuance

- o £4.10bn 2% 2020 (1.50x, 1.50%, Apr 15)
 - o £1.75bn 4¾% 2030 (1.37x, 2.34%, Aug 14)
 - o £0.75bn 1/8% IL 2058 (2.03x, -0.79%, Jan 15)
- Note: Issuance amounts are nominals.

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (319)	5,612	60.9
Non Sovereigns	3,597	39.1
AAA (560)	1,002	10.9
AA (539)	904	9.8
A (788)	833	9.0
BBB (887)	857	9.3

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (789)	2,115	23.0
3 – 5 Yrs (703)	1,876	20.4
5 – 7 Yrs (681)	1,603	17.4
7 – 10 Yrs (583)	1,622	17.6
10+ Yrs (337)	1,992	21.6

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ May 15 & 12)		W't (%)	Dur'n (yrs)
Gilts (24)	499	356	93.2	20.7
< 5 Yrs (4)	76	50	14.1	-
5 – 15 Yrs (5)	106	90	19.8	-
> 15 Yrs (15)	317	217	59.2	28.6
Non Gilts (40)	36	30	6.8	17.3

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

Month End	US (%)	Euro (%)	Sterling (%)
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	5.72	3.74	5.84
May '15	5.71	3.76	5.77

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

