



Investment Update September 2015

Investment Headlines & Comment

- Another bad month for **Commodities**, and for the **Basic Materials** sector.
- There was a marked upturn in daily **UK Equities'** volatility – FTSE100 moved by over 2% on 6 days.
- Credit margins increased on A- and BBB-rated **corporate bonds** and on **High Yield**.

Feature Section

This month we consider some features of global equity markets. These are still generally considered on a geographic basis – there was an attempt some 15-20 years ago to use a multinational / local approach, the idea being to separate out companies operating globally from those focused on local markets, but the geographic approach has remained the dominant model.

We start with the progression of market capitalization within worldwide equity markets. Figure 1a shows the market capitalization (market cap) proportions (using quarterly data) from December 1992 to the latest quarter end. It is interesting to see the extent to which the US weighting has varied over time (including its rally in the tech bubble, the ensuing reversal which then got extended by the “credit crunch”, before having a QE-led rally). Figure 1a also demonstrates that the UK and Japan weightings have been of pretty similar magnitude over much of the last 15 years.

Figure 1a: Equity market cap weightings

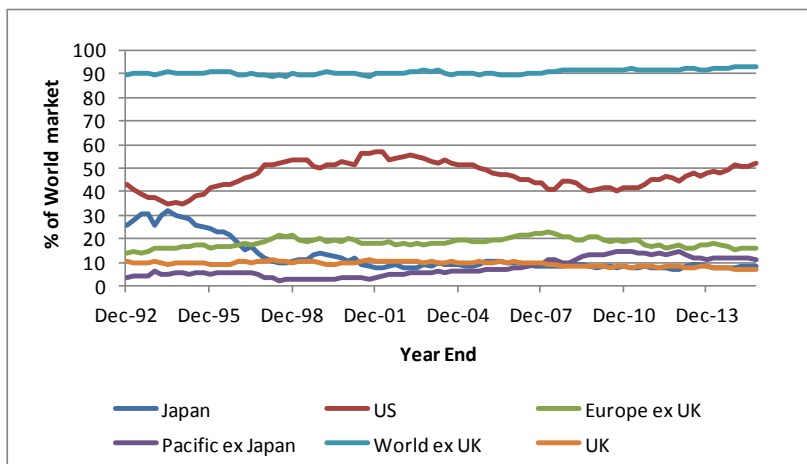
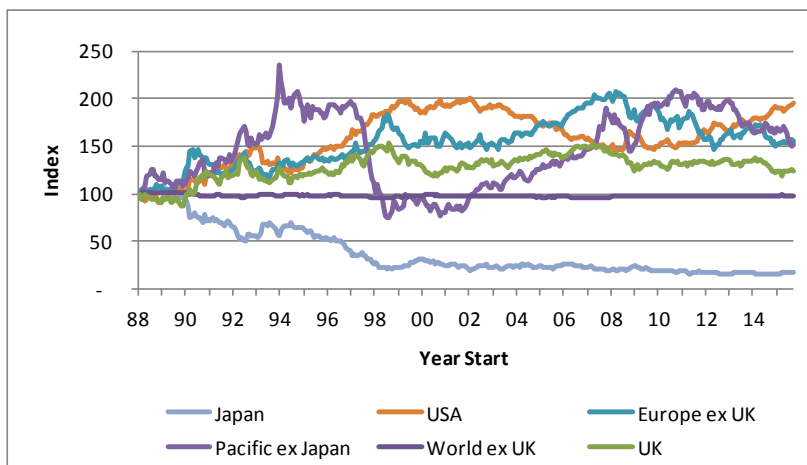


Figure 1b: Returns relative to the World index (sterling unhedged)



Source: FTSE

Many global equity funds have benchmarks based on worldwide market cap weightings but some have benchmarks based on fixed weightings, so it is worth considering how significant those effects can be. If a manager has persistent biases in their asset allocation, this analysis can help determine how much of the relative return is simply due to a position which could be implemented using index-tracking funds, and how much is down to manager skill.

One way to look at the significance of any fixed weightings is to consider the returns for the various regions, relative to the world equity index as a whole. Figure 1b does this (keeping the world equity total return fixed at 100, and starting when the FTSE indices did back in 1988).

It acts as a reminder of the persistence of the Japanese relative downturn, the severity of the short relative downturn for Pacific ex Japan in the late 1990s, and the current 5+ years of relative downturn which the same region has been going through.



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 September 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	-2.7	-5.7	-2.3	7.2	6.7	5.6	6.8
Overseas Equities	-2.0	-5.8	1.0	10.3	8.4	7.1	6.8
US Equities	-1.2	-3.2	6.1	14.9	14.2	8.6	7.5
Europe ex UK Equities	-3.2	-4.7	-1.8	9.5	5.0	5.7	8.4
Japan Equities	-5.2	-8.0	6.2	12.1	6.4	2.9	0.7
Pacific ex Japan Equities	-0.6	-13.2	-8.0	1.6	1.5	8.3	5.8
Emerging Markets	-1.4	-14.6	-13.3	-2.9	-2.5	6.2	5.8
UK Long-dated Gilts	1.8	5.1	14.0	6.7	8.8	7.2	8.5
UK Long-dated Corp. Bonds	0.2	1.0	4.7	5.7	7.2	5.9	-
UK Over 5 Yrs Index-Linked Gilts	-0.2	2.3	11.8	9.4	9.3	7.8	8.0
High Yield (Global)	-1.2	-1.0	1.4	5.3	6.4	8.9	-
Overseas Bonds	2.6	6.2	4.1	-0.6	0.7	5.3	4.8
Property *	1.0	3.5	15.7	13.3	10.4	5.7	8.8
Cash	0.0	0.1	0.6	0.5	0.7	2.3	3.9
Commodities £-converted	-4.8	-16.2	-37.6	-18.1	-9.1	-8.6	0.8
Hedge Funds original \$ basis *	-2.3	-3.9	-1.1	4.8	4.3	4.6	8.0
Illustrative £-converted version *	-0.8	-4.7	6.9	6.0	4.2	6.2	8.0
Euro relative to Sterling	1.3	4.1	-5.4	-2.5	-3.2	0.8	-
US \$ relative to Sterling	1.6	3.9	7.1	2.2	0.8	1.6	0.2
Japanese Yen relative to Sterling	2.8	6.2	-1.9	-11.5	-6.2	1.0	-0.7
Sterling trade weighted	-1.4	-2.8	2.8	2.5	2.6	-0.9	0.5
Price Inflation (RPI) *	0.5	0.5	1.1	2.3	3.0	3.0	2.8
Price Inflation (CPI) *	0.3	0.2	0.1	1.4	2.2	2.5	2.0
Price Inflation (RPIX) *	0.5	0.5	1.2	2.3	3.0	3.2	2.8
Earnings Inflation **	-0.5	-0.6	3.7	1.7	2.0	2.4	3.3
All Share Capital Growth	-2.9	-6.6	-5.6	3.6	3.1	2.0	3.3
Net Dividend Growth	0.1	0.2	4.9	4.3	6.4	4.2	-
Earnings Growth	2.4	-17.5	-22.4	-8.2	-0.5	0.7	3.1

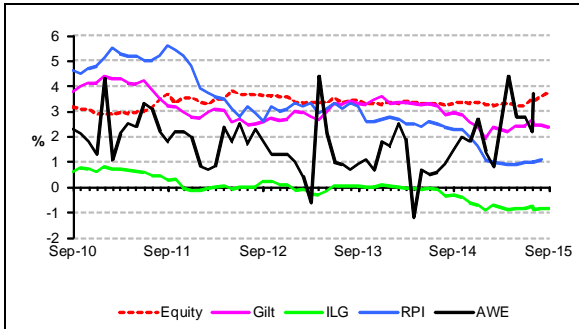
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

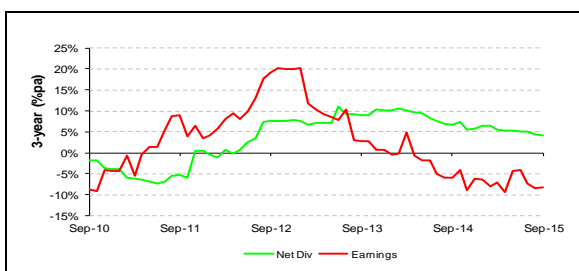
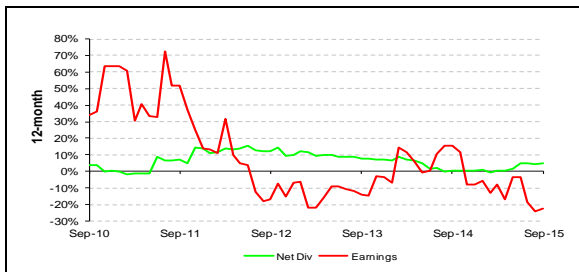


The gap gives a current expectation around 3.2% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

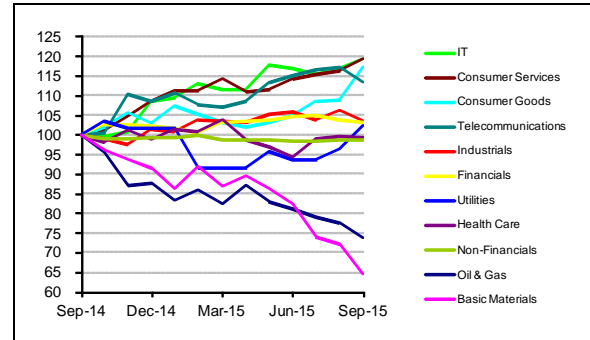
Figure 3: Dividend & Earnings Growth



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



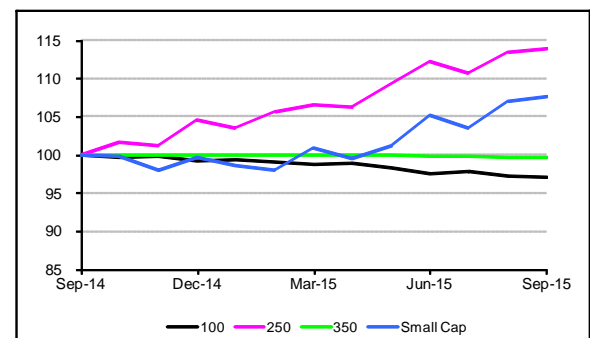
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (from 50% to 55%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-7.7	-14.6	-28.0
Basic Materials	-13.3	-26.3	-37.0
Industrials	-5.0	-7.8	1.2
Consumer Goods	4.8	5.4	14.7
Health Care	-3.2	-0.6	-3.0
Consumer Services	-0.2	-1.3	16.7
Telecommunications	-6.1	-7.3	10.7
Utilities	3.2	3.1	0.0
Non-Financials	-2.6	-5.3	-3.4
Financials	-3.2	-6.8	1.0
IT	-0.7	-3.9	16.5
All Share	-2.7	-5.7	-2.3

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

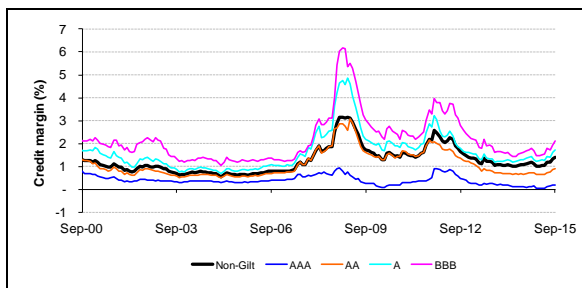


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Apr '15	3.30	2.44	0.86
May '15	3.30	2.43	0.87
Jun '15	3.65	2.65	1.00
Jul '15	3.45	2.49	0.96
Aug '15	3.61	2.49	1.12
Sep '15	3.59	2.39	1.20

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

Category	Mkt Val @ Sep 15 & 12, 09			Weight (%)
Gilts (38)	1,241	1,097	668	69.7
Non Gilts (1,045)	539	525	481	30.3
AAA (118)	101	140	150	5.7
AA (196)	97	66	66	5.5
A (340)	159	171	165	8.9
BBB (391)	181	147	97	10.2

Category	Mkt Val @ Sep 15, & 12		W't (%)	Dur'n (yrs)
Gilts (38)	1,241	1,097	69.7	10.5
< 5 Yrs (11)	359	292	20.2	2.8
5-15 Yrs (11)	348	365	19.5	7.1
> 15 Yrs (16)	534	439	30.0	18.0
Non Gilts (1,045)	539	525	30.3	7.8
< 5 Yrs (352)	163	143	9.2	2.5
5-15 Yrs (450)	230	216	12.9	7.5
> 15 Yrs (243)	146	165	8.2	14.2

£ Gilt Market “main” Issuance

- £3.75bn 1½% 2021 (1.45x, 1.46%, new)
 - £3.25bn 2% 2025 (1.35x, 1.95%, Aug 15)
 - £2.00bn 3½% 2045 (1.39x, 2.45%, Jul 15)
 - All 3 of these had non-exercise of the post auction option to buy another 10%
 - £2.50bn 1/8% IL 2068 (1.81x, ry -0.87%, Jan 14)
- Note: Issuance amounts are nominals.*

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (319)	5,639	61.6
Non Sovereigns	3,510	38.4
AAA (565)	962	10.5
AA (562)	920	10.1
A (784)	813	8.9
BBB (900)	815	8.9

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (779)	2,101	23.0
3 – 5 Yrs (736)	1,875	20.5
5 – 7 Yrs (699)	1,567	17.1
7 – 10 Yrs (590)	1,695	18.5
10+ Yrs (326)	1,911	20.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Sep 15 & 12)		W't (%)	Dur'n (yrs)
Gilts (25)	484	324	93.2	21.8
< 5 Yrs (3)	50	28	9.6	-
5 – 15 Yrs (7)	124	88	24.0	-
> 15 Yrs (15)	309	208	59.7	29.6
Non Gilts (38)	35	29	6.8	17.3

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

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

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

