

## Investment Update October 2017



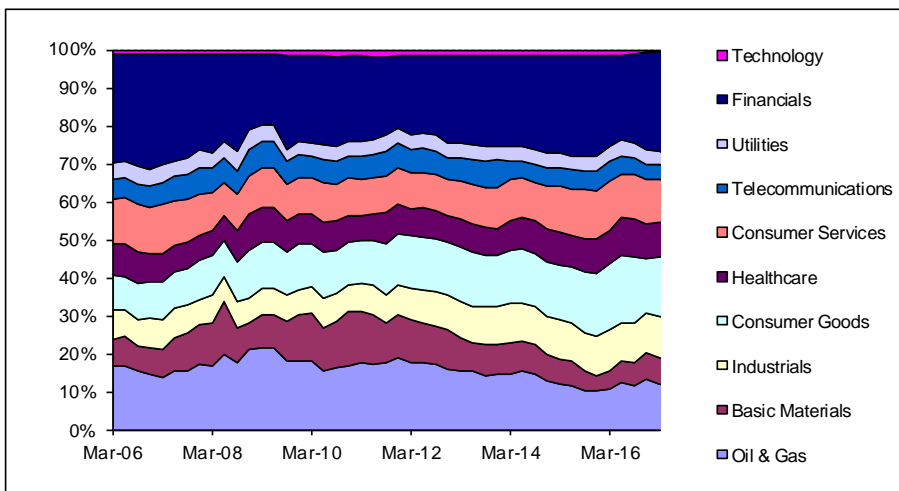
### Investment Headlines & Comment

- A strong month for Overseas Equities, particularly in the Far East and Emerging Markets.
- A relatively quiet month in UK bond markets, and Sterling was pretty stable as well.
- Table 1 now has a 20-year All Share Dividend Growth figure (net from 1997 to April 2016).

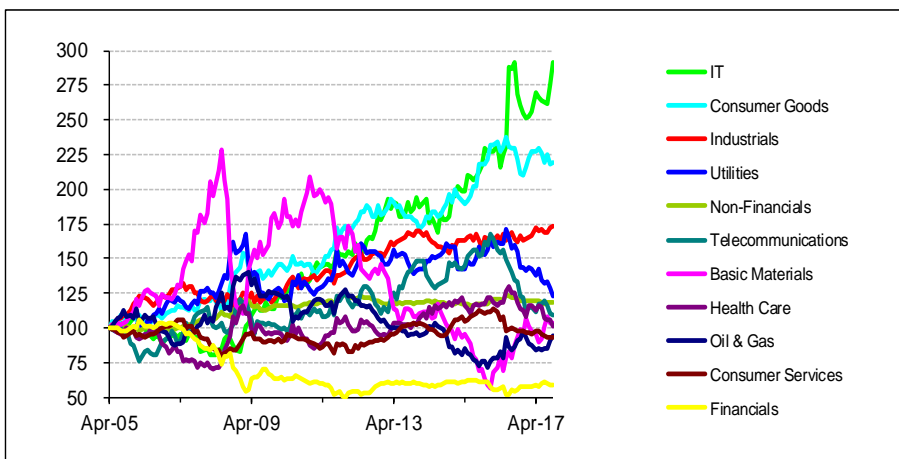
**Feature Section** This month we update our analysis of the evolution of the All Share index sector weightings and returns over the period since early 2006 when the current broad categorization labels were introduced. We last looked at this in our [April 2015](#) issue.

Figure 1a shows that the Technology sector has now all but disappeared, after the sale of ARM to Softbank (see the news item in our [July 2016](#) issue). Apart from that, the current sector weightings are pretty close to those at the time of our 2015 analysis. Except for the Basic Materials spike and reversal in 2008, there is relatively little in Figure 1a that is “jagged” in nature. Figure 1b shows the cumulative total returns for the various sectors, relative to the All Share being fixed at 100. Even with the material dispersion in sector returns shown in Figure 1b, the weighting changes in Figure 1a are overall still pretty gradual.

**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

Also, Figure 1b’s cumulative dispersion is pretty striking – the minnow IT has ended up 190% ahead of the All Share (in geometric terms) over the period, and the rather larger Consumer Goods sector has ended up 119% ahead, whereas Financials has just gone more or less sideways in relative terms since the “credit crunch”, and has ended up 41% behind.

These are unannualised, but even if you annualise them, you still come out with material divergences of 9% p.a. and 6% p.a. ahead and minus 4% p.a. behind, respectively.

The relative progression of the Industrials sector is generally smooth, whereas the other cumulative relative return lines are rather more volatile, with Basic Materials being the prime example (its end value is just 4% ahead of the All Share, having been over 128% ahead and 44% behind at other points in the chart).



**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 October 2017**

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	1.9	2.8	13.4	9.4	10.2	5.5	6.4
Overseas Equities	3.3	3.9	14.0	16.0	16.4	9.5	8.2
US Equities	3.3	4.0	13.8	17.7	<b>19.7</b>	<b>12.5</b>	8.0
Europe ex UK Equities	1.4	3.4	<b>19.6</b>	14.6	14.3	6.0	8.7
Japan Equities	<b>5.8</b>	<b>6.1</b>	9.2	<b>18.1</b>	17.3	7.4	4.7
Pacific ex Japan Equities	5.2	3.8	16.1	14.2	11.8	7.5	<b>9.6</b>
Emerging Markets	4.6	4.7	16.7	12.9	9.3	5.6	9.4
UK Long-dated Gilts	0.5	-0.2	0.7	9.1	7.2	8.4	7.5
UK Long-dated Corp. Bonds	0.6	-0.2	4.1	8.7	7.6	8.0	-
UK Over 5 Yrs Index-Linked Gilts	1.0	1.6	-2.7	10.4	9.9	9.0	7.9
High Yield (Global)	1.3	0.8	1.5	12.1	10.3	<b>12.5</b>	-
Overseas Bonds	0.6	-1.2	-8.7	7.7	3.7	7.9	5.7
Property *	1.0	2.7	10.4	9.5	10.9	4.3	8.7
Cash	<b>0.0</b>	0.1	0.3	<b>0.5</b>	<b>0.5</b>	<b>1.3</b>	<b>3.3</b>
Commodities £-converted	4.9	5.7	-1.4	-11.5	-9.6	-6.4	-0.9
Hedge Funds original \$ basis *	0.7	2.3	7.2	3.4	4.7	3.1	6.3
Illustrative £-converted version *	-3.3	-1.0	3.8	10.2	8.7	7.5	7.3
Euro relative to Sterling	-0.5	-1.9	-2.3	3.9	1.7	2.3	-
US \$ relative to Sterling	1.0	-0.7	-8.1	6.4	3.9	4.6	1.2
Japanese Yen relative to Sterling	0.1	-3.5	-15.0	5.9	-3.1	4.7	1.5
Sterling trade weighted	0.1	1.7	5.5	-3.7	-1.4	-2.7	-1.1
Price Inflation (RPI) *	0.1	1.0	3.9	2.2	2.4	2.8	2.8
Price Inflation (CPI) *	0.3	0.8	3.0	1.2	1.5	2.4	2.0
Price Inflation (RPIX) *	0.1	1.1	4.1	2.4	2.5	3.2	2.8
Earnings Inflation **	-1.0	-1.0	2.3	2.6	1.8	1.9	3.1
All Share Capital Growth	1.7	1.8	9.3	5.5	6.4	1.8	3.0
Dividend Growth	0.3	3.5	12.7	8.2	6.4	4.5	4.4
Earnings Growth	9.7	27.1	51.9	-8.6	-6.2	-3.6	2.0

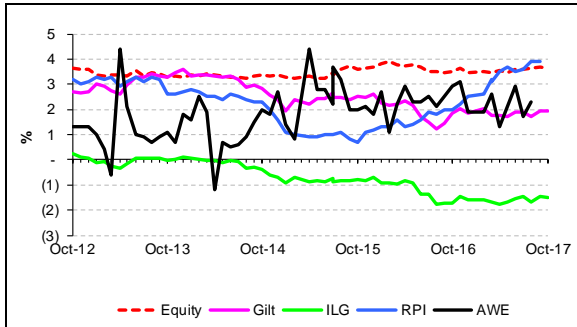
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – MSCI IPD UK Monthly Property 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.

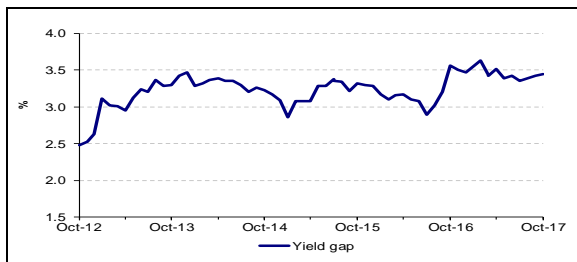


## Yields and Yield Gaps

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.

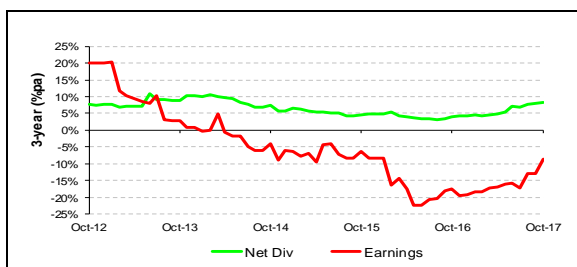
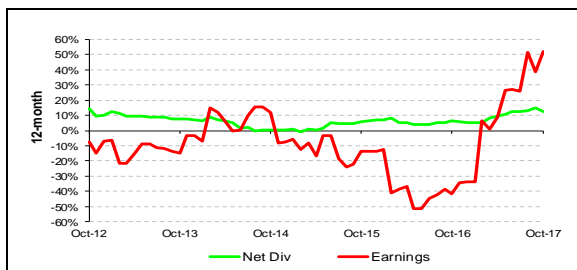


The gap gives a current expectation around 3.4% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

## 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]

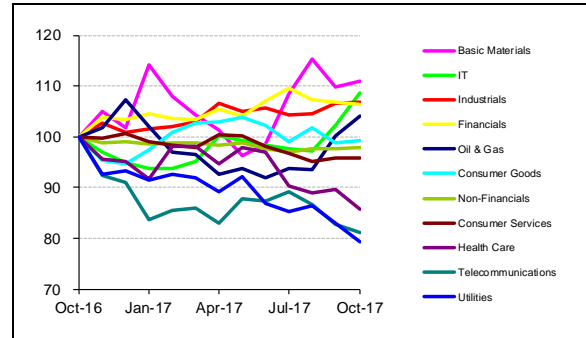
Figure 3: Dividend & Earnings Growth



Note: Earnings data from mid 2015 onwards is under review by FTSE Russell as one-off events may be affecting the prospective P/E ratios

## UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



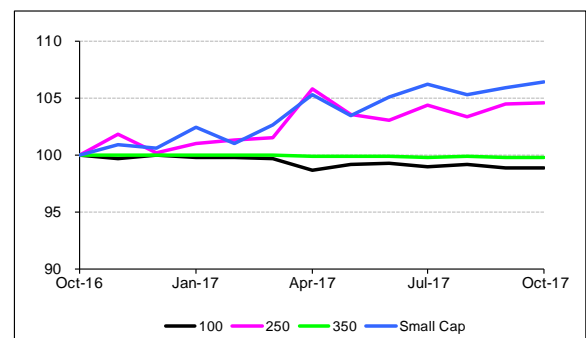
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 38% to 32%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	5.7	14.1	17.9
Basic Materials	2.9	5.3	25.8
Industrials	2.1	5.3	21.1
Consumer Goods	2.3	3.1	12.4
Health Care	-2.6	-2.3	-2.8
Consumer Services	1.8	1.9	8.5
Telecommunications	-0.2	-6.2	-7.9
Utilities	-2.8	-4.6	-10.2
Non-Financials	2.0	3.9	11.0
Financials	1.5	0.0	20.7
IT	8.2	14.4	23.2
All Share	1.9	2.8	13.4

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



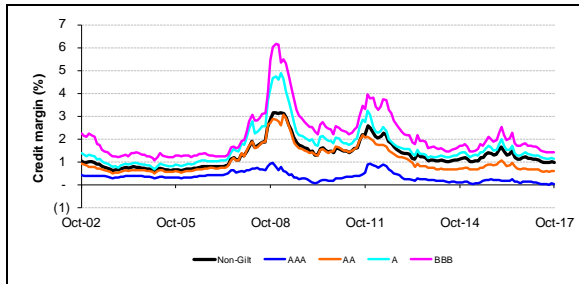
Mid Cap and Small Cap rose in relative terms this month.

Sources for charts on this page:  
Financial Times, Office for National Statistics, J&A



**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 (%)
May '17	2.41	1.71	0.70
Jun '17	2.55	1.89	0.66
Jul '17	2.53	1.88	0.65
Aug '17	2.38	1.72	0.66
Sep '17	2.62	1.94	0.68
Oct '17	<b>2.62</b>	<b>1.93</b>	<b>0.69</b>

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

Category	Mkt Val @ Oct 17 & 14, 11			Weight (%)
	Oct 17	Oct 14	Oct 11	
Gilts (41)	1,332	1,153	928	70.0
Non Gilts (1,048)	572	546	473	30.0
AAA (135)	112	104	129	5.9
AA (172)	89	91	78	4.7
A (324)	160	175	163	8.4
BBB (417)	212	176	103	11.1

Category	Mkt Val @ Oct 17 & 14		W't (%)	Dur'n (yrs)
Gilts (41)	1,332	1,153	70.0	11.7
< 5 Yrs (12)	403	334	21.2	2.9
5-15 Yrs (11)	347	359	18.2	8.3
> 15 Yrs (18)	582	459	30.6	19.8
Non Gilts (1,048)	572	546	30.0	8.1
< 5 Yrs (378)	186	160	9.8	2.8
5-15 Yrs (445)	238	231	12.5	7.7
> 15 Yrs (225)	148	154	7.8	15.3

**£ Gilt Market “main” Issuance**

- £3.16bn ¾% 2023 (2.36x, 0.91%, Aug 17)
  - £2.60bn 1¼% 2027 (2.15x, 1.32%, Sep 17)
  - £2.50bn 1¾% 2037 (1.85x, 1.94%, May 17)
  - £0.65bn 5/8% IL 2042 (2.37x, ry -1.55%, Nov 14)
- Note: Issuance amounts are nominals.

**Tables 2d, 2e: € Market Size and Maturity (Oct 17)**

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (346)	6,030	59.5
Non Sovereigns	4,105	40.5
AAA (800)	1,168	11.5
AA (642)	1,028	10.1
A (867)	853	8.4
BBB (1,204)	1,057	10.4

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (848)	2,233	22.0
3 – 5 Yrs (1,040)	2,190	21.6
5 – 7 Yrs (796)	1,639	16.2
7 – 10 Yrs (765)	1,844	18.2
10+ Yrs (410)	2,229	22.0

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

Category (Number of issues)	Mkt Val (£bn @ Oct 17 & 14)		W't (%)	Dur'n (yrs)
	Oct 17	Oct 14		
Gilts (28)	650	446	100.0	22.3
< 5 Yrs (3)	51	44	7.8	1.6
5 – 15 Yrs (7)	149	135	23.0	8.1
> 15 Yrs (18)	449	267	69.2	29.4

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

Month End	US (%)	Euro (%)	Sterling (%)
May '17	5.24	3.10	5.30
Jun '17	5.32	3.09	5.42
Jul '17	5.21	2.97	5.35
Aug '17	5.28	3.00	5.33
Sep '17	5.21	2.92	5.25
Oct '17	<b>5.22</b>	<b>2.73</b>	<b>5.15</b>

Sources: DMO, FTSE, iBoxx, J&A, MLX

