



Investment Update

April 2017

Investment Headlines & Comment

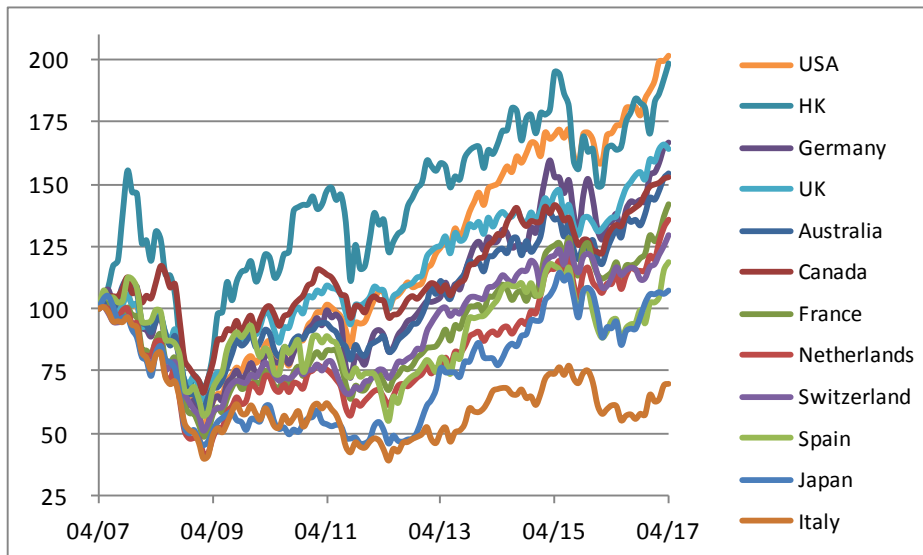
- **Sterling** strengthened off the UK's election announcement, now back to near post-Referendum highs.
- Real yields on **ILGs** are back down to their mid-2016 lows, but nominal yields have barely moved.
- So, is there any genuine upturn in **inflation expectations**, or just a mania in a limited marketplace?

Feature Section

This month, as equity markets continue to demonstrate Teflon-like resilience, we consider the profile of local currency returns in various equity markets over the last 10 years. Data is from the FTSE All-World series, so it is slightly skewed to large cap stocks, rather than being the entire stock market in each country, but it still seems a reasonable dataset upon which to base this.

Figure 1 shows the total returns in local currency (to strip out distortions from any short-term Sterling gyrations), and starting each market at 100. The legend labels are in end-value order for ease of reference. Apart from Italy, each market has shown a positive 10-year return but the dispersion of the end values is pretty striking, even when converted from cumulative indices into annualized returns. For example, the US index has returned 7.3% p.a. and the UK index has returned 5.1% p.a. whereas Italy has only managed minus 3.5% p.a. and Japan has produced 0.7% p.a. Also, Figure 1 shows there was significant variation in terms of how long it took different markets to recover their 2008/09 "credit crunch" losses (and Italy still has not done so). Interestingly, nine of the twelve markets shown have end values which are at their highest over the 10 years shown, and one other (the UK) is extremely close to its past high.

Figure 1: Cumulative 10-year local currency returns



Source: FTSE All-World

If you extend the data set to cover the last 20 years, and thus are incorporating the tech bubble and subsequent crash, plus the Iraq War downturn, you still get to similar conclusions, although the annualized returns change a bit: over 20 years, the US index has returned 7.7% p.a. and the UK index has returned 6.1% p.a. whereas, over 20 years, Italy has been less adrift in producing 4.1% p.a. but Japan has still only produced a lacklustre 1.9% p.a. Again, nine of the twelve markets

shown have end values at their highest over the 20 years, and the UK is extremely close to its past high.

However, this scenario of "most developed markets hitting highs *at the same time*" (our emphasis) really does prompt the question for even long-term equity-oriented investors of whether it is becoming time to take (at least some of) the money and run. There are those optimists who cite a broad, synchronized recovery in markets and hence that sunny times can continue, but with Quantitative Easing set to go into reverse at some stage (particularly if there are signs of materially increased inflation), and against a background of many developed government debt markets at huge levels still needing eventual resolution (whether by personal or corporate tax increases, or other means), is the risk of an equity shock worth taking? The answer will clearly be influenced by individual investors' situations and risk tolerances, but it's definitely worth at least asking the question.



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 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	-0.4	4.0	20.1	6.8	9.7	5.4	6.5
Overseas Equities	-1.8	3.0	32.0	16.6	15.2	9.4	8.1
US Equities	-2.3	2.3	33.9	20.5	18.9	12.0	7.9
Europe ex UK Equities	0.8	7.3	29.0	9.9	13.7	5.6	9.0
Japan Equities	-2.2	-0.4	26.6	18.4	13.6	5.9	3.7
Pacific ex Japan Equities	-2.1	5.1	36.3	14.1	10.4	9.6	7.3
Emerging Markets	-1.2	5.1	35.4	11.7	6.6	7.4	7.4
UK Long-dated Gilts	0.2	6.1	14.9	13.7	9.1	8.9	8.4
UK Long-dated Corp. Bonds	0.5	5.2	15.6	11.1	9.9	7.9	-
UK Over 5 Yrs Index-Linked Gilts	2.6	4.6	28.5	15.2	10.6	10.0	8.7
High Yield (Global)	-1.8	-0.1	26.3	13.1	11.4	11.9	-
Overseas Bonds	-2.3	-1.3	9.4	8.8	4.2	8.1	5.8
Property *	0.9	2.3	3.8	11.2	10.0	3.9	8.8
Cash	0.0	0.1	0.4	0.5	0.5	1.6	3.4
Commodities £-converted	-5.4	-8.3	9.2	-16.3	-11.3	-5.2	-0.9
Hedge Funds original \$ basis *	0.3	2.4	8.7	2.9	4.1	3.3	6.9
Illustrative £-converted version *	-0.1	1.2	24.9	13.2	9.3	8.1	8.4
Euro relative to Sterling	-1.6	-2.0	7.7	0.8	0.6	2.1	-
US \$ relative to Sterling	-3.3	-2.8	13.2	9.3	4.7	4.5	1.1
Japanese Yen relative to Sterling	-3.4	-1.8	8.7	6.2	-2.1	5.2	1.8
Sterling trade weighted	2.5	2.3	-8.1	-2.9	-1.0	-2.7	-0.9
Price Inflation (RPI) *	0.3	0.8	3.1	1.9	2.3	2.8	2.8
Price Inflation (CPI) *	0.4	0.6	2.3	0.9	1.4	2.3	2.0
Price Inflation (RPIX) *	0.3	0.9	3.4	2.0	2.3	3.1	2.8
Earnings Inflation **	3.3	6.3	2.7	1.4	1.5	1.2	3.3
All Share Capital Growth	-0.7	2.7	15.8	3.1	5.8	1.7	3.1
Net Dividend Growth	1.0	3.9	9.6	4.9	6.1	4.1	-
Earnings Growth	2.2	12.3	8.7	-17.0	-12.6	-5.1	0.9

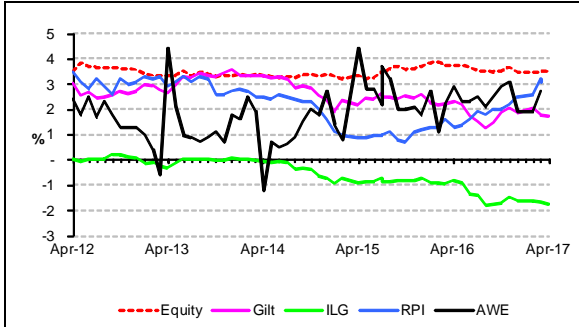
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – 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.

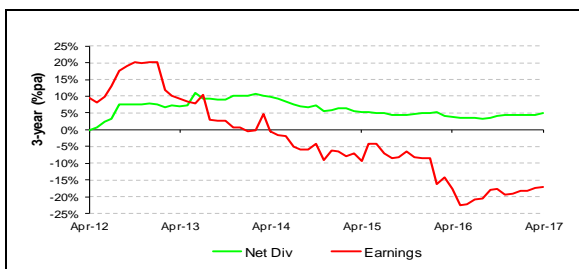
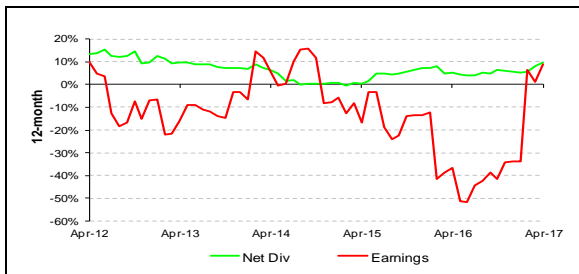


The gap gives a current expectation around 3.5% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

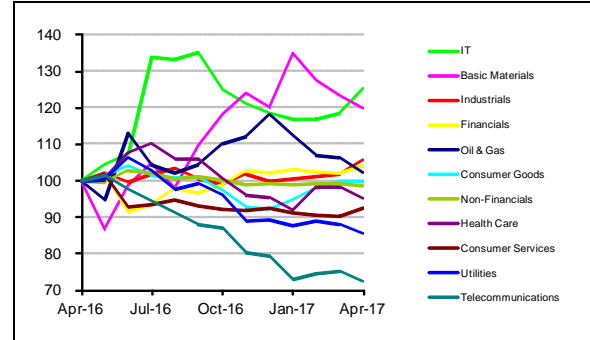
Figure 3: Dividend & Earnings Growth



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



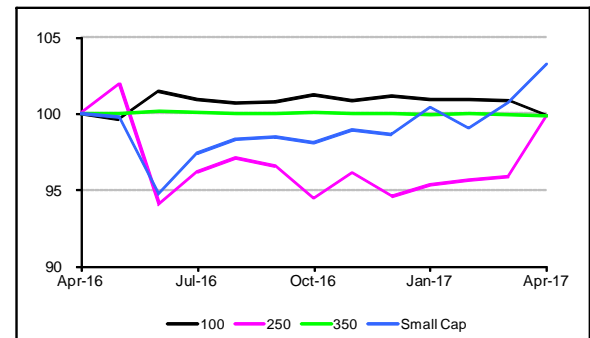
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 64% to 53%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-4.3	-5.5	22.6
Basic Materials	-3.2	-7.6	43.9
Industrials	3.3	9.3	26.8
Consumer Goods	-0.2	9.8	20.1
Health Care	-3.7	7.5	14.2
Consumer Services	2.2	5.5	11.1
Telecommunications	-4.0	3.2	-13.2
Utilities	-3.4	1.2	2.6
Non-Financials	-1.0	3.7	18.4
Financials	1.5	4.9	25.1
IT	5.1	11.3	50.3
All Share	-0.4	4.0	20.1

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid and Small Cap rose in relative terms this month.

FRS17 volatility indicator

Now discontinued, but available on request.

Sources for charts on this page:

Financial Times, Office for National Statistics, J&A



Bond market information

Figure 5: £ Non-Gilt Credit Margins

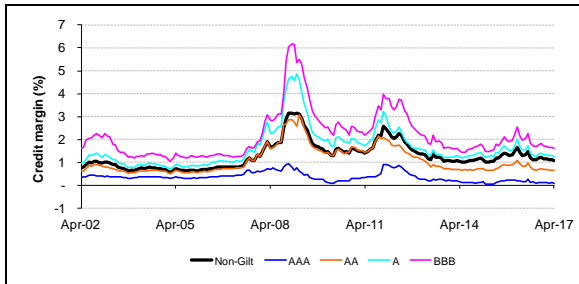


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Nov '16	2.82	2.03	0.79
Dec '16	2.60	1.86	0.74
Jan '17	2.77	2.03	0.74
Feb '17	2.50	1.77	0.73
Mar '17	2.50	1.76	0.74
Apr '17	2.50	1.75	0.75

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

Category	Mkt Val @ Apr 17 & 14, 11			Weight (%)
	17	14	11	
Gilts (41)	1,359	1,085	811	70.7
Non Gilts (1,017)	564	530	468	29.3
AAA (131)	110	101	127	5.7
AA (166)	88	87	74	4.6
A (338)	171	169	165	8.9
BBB (382)	195	172	102	10.2

Category	Mkt Val @ Apr 17 & 14		W't (%)	Dur'n (yrs)
Gilts (41)	1,359	1,85	70.7	11.8
< 5 Yrs (11)	385	309	20.0	2.9
5-15 Yrs (11)	342	375	17.8	7.7
> 15 Yrs (19)	632	401	32.8	19.3
Non Gilts (1,017)	564	530	29.3	8.2
< 5 Yrs (340)	165	153	8.6	2.8
5-15 Yrs (449)	241	226	12.6	7.5
> 15 Yrs (228)	157	151	8.2	15.1

£ Gilt Market “main” Issuance

- £3.16bn ½% 2022 (2.15x, 0.52%, Mar 17)
 - £3.17bn 1¼% 2027 (2.02x, 1.13%, Mar 17)
 - £1.72bn 2½% 2065 (1.65x, 1.52%, Oct 16)
 - £0.86bn 1/8% IL 2046 (1.87x, ry -1.67%, Jan 17)
- Note: Issuance amounts are nominals.

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (339)	5,849	59.8
Non Sovereigns	3,934	40.2
AAA (763)	1,136	11.6
AA (630)	1,007	10.3
A (832)	812	8.3
BBB (1,116)	979	10.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (782)	2,087	21.3
3 – 5 Yrs (993)	2,149	22.0
5 – 7 Yrs (771)	1,645	16.8
7 – 10 Yrs (753)	1,802	18.4
10+ Yrs (381)	2,100	21.5

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Apr 17 & 14)		W't (%)	Dur'n (yrs)
Gilts (28)	670	401	100.0	23.3
< 5 Yrs (3)	51	44	7.6	2.1
5 – 15 Yrs (7)	150	125	22.3	8.6
> 15 Yrs (18)	469	231	70.1	30.2

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

Month End	US (%)	Euro (%)	Sterling (%)
Nov '16	5.84	3.77	6.04
Dec '16	5.61	3.45	5.80
Jan '17	5.49	3.39	5.75
Feb '17	5.32	3.30	5.52
Mar '17	5.43	3.42	5.59
Apr '17	5.30	3.23	5.49

Sources: DMO, iBoxx, J&A, MLX

