



Investment Headlines & Comment

- Another strong month for UK equities, with positive returns for most other assets as well.
- LGPS introduces a [transparency code](#) to try to get a better feel for managers' transaction costs.
- Another DMO record - £26.4bn of offers chasing £5bn of 40-year gilt on a redemption yield of 1.69%.

Feature Section

This month, we revisit the question of ethical investment, which we last considered in our [August 2010](#) edition. At that stage, the ethical sub-index for UK Equities had tended to underperform the All Share as a whole for quite a while, and it seemed that ethical principles came at a “performance cost” of over 1% p.a. How have things progressed since then, and why?

Environmental, social, and governance (ESG) is a general term for the criteria that measure the sustainability and ethical impact of a company.

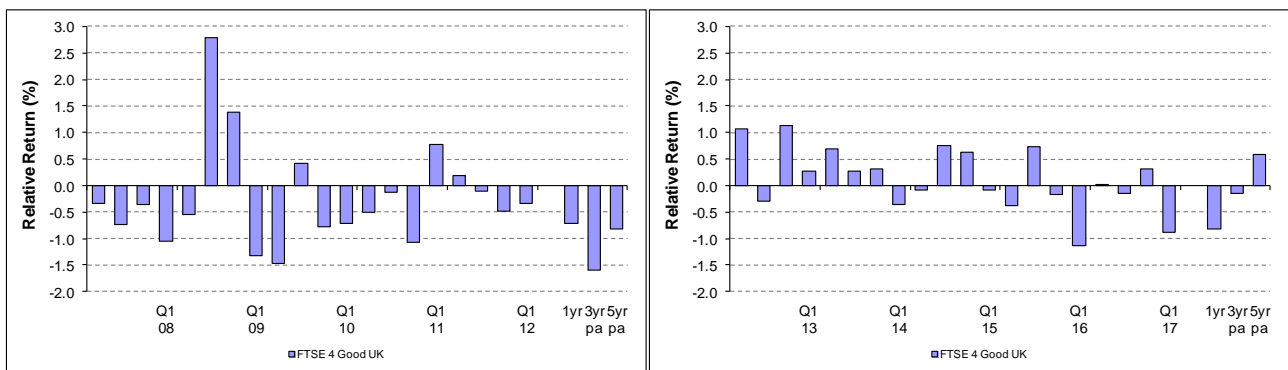
- Environmental criteria – how great are environmental issues to it e.g. carbon footprint, climate change, nuclear energy, and sustainability?
- Social criteria – how does it manage relationships with its employees, suppliers, customers and communities?
- Governance – this deals with its leadership, executive pay, and internal controls.

Most, if not all, investment managers will have their own ESG policies (and generic central ESG policies for managers to follow have been developed by third

parties, e.g. Red Line Voting, although these have not been particularly successful as yet). The problem is that all managers' ESG policies are different and subjective, and many may not be strong enough to be classed as “ethical”.

Some ethical indices, such as the Dow Jones Sustainability World Index and FTSE Environmental Technologies (ET) 100 Index, have sub-sector allocations well away from the conventional market cap indices. If the ethical criteria are milder (e.g. “no tobacco”, “no armaments”), then at the sector level, the lack of sector differences can be quite surprising. For example the Oil and Gas weighting is still rather high in many ethical indices (Royal Dutch Shell is the single largest holding in the FTSE4Good UK Index).

Figure 1a: 10 Years' quarterly relative returns for FTSE4Good vs FTSE All Share



Source: FTSE

The 5 years to Q1 2012 were generally negative for FTSE4Good UK relative returns, but that index is slightly ahead of the FTSE All Share over the subsequent 5-year period to Q1 2017. Figure 1b shows that over the last 5 years the returns of the All-Share Tobacco and Aerospace & Defence sub-sectors are behind within the consumer goods and industrials sectors, respectively. Excluding those sub-sectors should have led to outperformance versus the FTSE All Share, however the larger weighting in Health Care at the expense of the Consumer Goods sector would have had a detrimental impact.

Figure 1b: Sector Returns to 31 March 2017

Sector	5 Year (% p.a.)	10 Year (% p.a.)
Consumer Goods	15.5	13.0
Tobacco	14.9	15.4
Industrials	12.0	8.4
Aerospace & Defence	8.7	6.6
Oil and Gas	3.2	5.6
Health Care	13.4	9.3
Total Return	9.7	5.7

Source: FTSE All Share



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 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	4.4	5.3	24.5	7.8	12.2	5.5	6.6
Overseas Equities	2.4	1.2	33.9	16.3	16.6	9.2	7.9
US Equities	1.6	-1.1	32.7	19.9	19.5	11.7	8.0
Europe ex UK Equities	5.2	10.8	35.8	10.9	16.8	5.8	8.8
Japan Equities	3.3	0.3	30.9	17.8	15.2	5.9	3.4
Pacific ex Japan Equities	2.5	2.9	41.2	13.5	12.1	9.2	7.1
Emerging Markets	3.6	4.4	44.7	11.4	8.7	7.1	7.5
UK Long-dated Gilts	0.8	1.8	12.0	13.4	7.7	9.2	8.2
UK Long-dated Corp. Bonds	2.0	3.1	15.3	11.1	9.5	8.2	-
UK Over 5 Yrs Index-Linked Gilts	-1.8	1.5	23.4	14.0	9.4	10.0	8.7
High Yield (Global)	1.5	-0.9	27.3	13.0	11.2	11.9	-
Overseas Bonds	1.8	-0.9	12.3	9.0	3.5	8.4	5.9
Property *	0.7	2.3	4.0	11.0	10.1	3.9	8.8
Cash	0.0	0.1	0.4	0.5	0.5	1.5	3.4
Commodities £-converted	-1.0	-10.4	5.1	-16.7	-10.0	-5.2	-1.0
Hedge Funds original \$ basis *	0.5	1.8	8.2	3.1	4.3	3.2	7.0
Illustrative £-converted version *	-2.8	-1.0	22.6	12.7	9.1	7.8	8.2
Euro relative to Sterling	3.3	1.8	13.6	2.2	1.6	2.5	-
US \$ relative to Sterling	0.6	-3.2	13.2	9.2	3.7	4.4	1.2
Japanese Yen relative to Sterling	1.0	-2.5	13.1	6.1	-3.3	5.4	1.5
Sterling trade weighted	-2.2	0.3	-11.5	-3.6	-1.3	-2.9	-1.0
Price Inflation (RPI) *	0.5	1.9	3.5	1.9	2.2	2.8	2.8
Price Inflation (CPI) *	0.4	1.5	2.7	0.9	1.4	2.3	2.0
Price Inflation (RPIX) *	0.5	2.0	3.8	2.0	2.3	3.1	2.8
Earnings Inflation **	8.5	12.2	2.4	3.0	2.0	2.3	3.5
All Share Capital Growth	3.9	4.1	20.0	4.0	8.3	1.8	3.2
Net Dividend Growth	1.8	3.5	10.7	5.5	6.2	4.3	-
Earnings Growth	0.7	4.4	26.3	-16.0	-11.7	-5.6	0.9

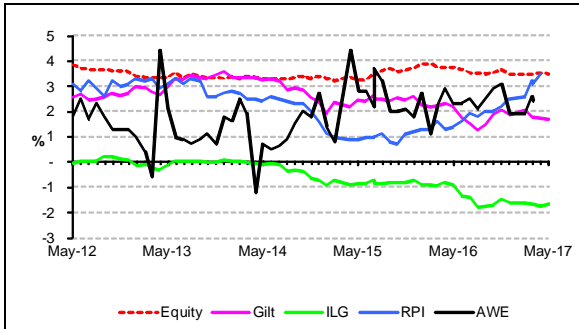
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

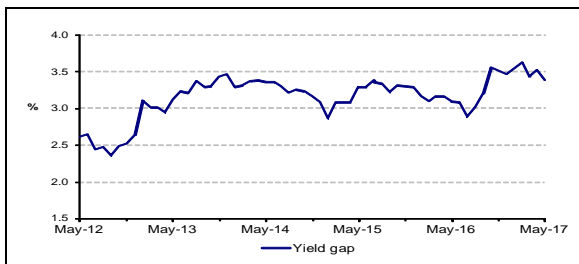


Yields and Yield Gaps

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.

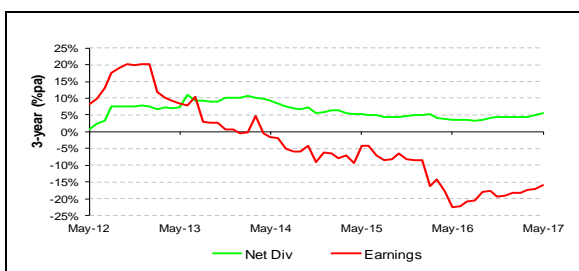
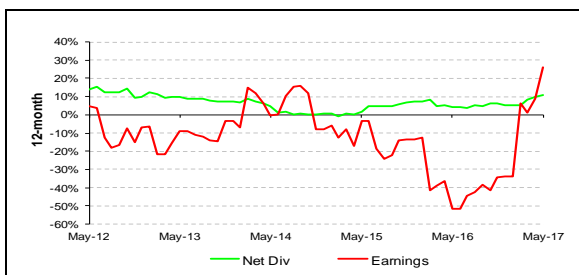


The gap gives a current expectation around 3.4% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

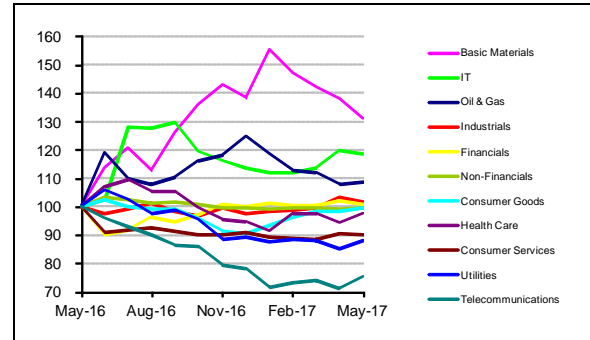
Figure 3: Dividend & Earnings Growth



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



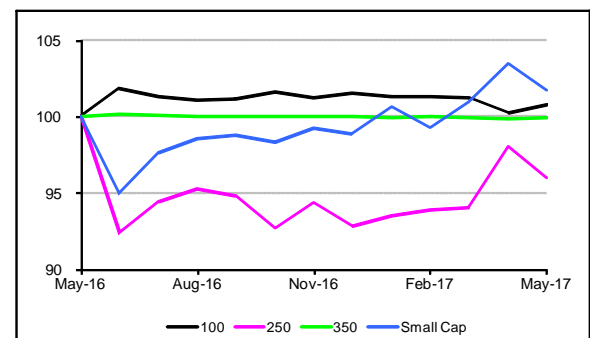
Note: Sector labels for relative lines are in end-value order

There was a slight rise this month in the rolling 12-month sector dispersion (from 53% to 55%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	5.5	1.7	35.7
Basic Materials	-1.0	-6.3	63.1
Industrials	2.8	8.4	26.7
Consumer Goods	5.4	8.4	23.9
Health Care	7.8	5.0	21.6
Consumer Services	3.9	7.0	12.6
Telecommunications	10.6	8.1	-6.0
Utilities	7.9	4.6	9.8
Non-Financials	4.8	5.1	24.0
Financials	3.0	5.7	25.7
IT	3.3	11.4	47.9
All Share	4.4	5.3	24.5

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.

Sources for charts on this page:

Financial Times, Office for National Statistics, J&A



Bond market information

Figure 5: £ Non-Gilt Credit Margins

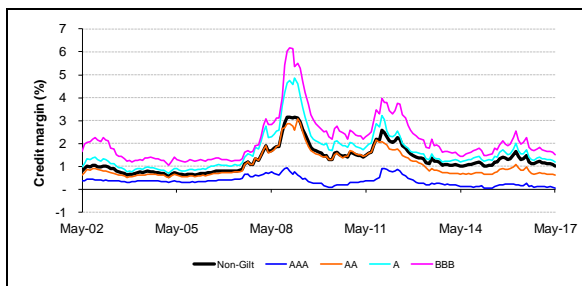


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
May '17	2.41	1.71	0.70

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

Category	Mkt Val @ May 17 & 14, 11			Weight (%)
	May 17	May 14	May 11	
Gilts (41)	1,374	1,102	833	70.8
Non Gilts (1,017)	568	538	474	29.2
AAA (130)	110	103	129	5.6
AA (167)	89	88	75	4.6
A (338)	172	172	166	8.8
BBB (382)	198	174	104	10.2

Category	Mkt Val @ May 17 & 14		W't (%)	Dur'n (yrs)
Gilts (41)	1,374	1,102	70.8	11.8
< 5 Yrs (11)	386	310	19.9	2.9
5-15 Yrs (11)	349	382	18.0	7.7
> 15 Yrs (19)	639	410	32.9	19.4
Non Gilts (1,017)	568	538	29.2	8.3
< 5 Yrs (345)	168	154	8.6	2.8
5-15 Yrs (445)	241	231	12.4	7.6
> 15 Yrs (227)	159	153	8.2	15.2

£ Gilt Market “main” Issuance

- £2.96bn 1¾% 2019 (2.35x, 0.11%, Feb 17)
 - £2.29bn 1¾% 2037 (2.15x, 1.76%, Jan 17)
 - £5.00bn 1¾% 2057 (**5.28x**, 1.69%, Jan 17)
 - £0.88bn 1/8% IL 2036 (2.17x, ry -1.78%, Mar 17)
- Note: Issuance amounts are nominals.

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (340)	5,878	59.8
Non Sovereigns	3,946	40.2
AAA (766)	1,142	11.6
AA (629)	1,000	10.2
A (839)	823	8.4
BBB (1,117)	981	10.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (789)	2,124	21.6
3 – 5 Yrs (1,006)	2,177	22.2
5 – 7 Yrs (765)	1,572	16.0
7 – 10 Yrs (756)	1,811	18.4
10+ Yrs (375)	2,139	21.8

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ May 17 & 14)		W't (%)	Dur'n (yrs)
Gilts (28)	659	407	100.0	23.0
< 5 Yrs (3)	51	44	7.7	2.0
5 – 15 Yrs (7)	149	126	22.6	8.5
> 15 Yrs (18)	459	237	69.7	30.0

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

Month End	US (%)	Euro (%)	Sterling (%)
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
May '17	5.24	3.10	5.30

Sources: DMO, iBoxx, J&A, MLX

