



Investment Update February 2018

Investment Headlines & Comment

- A poor month for most equities, and for Sterling, plus credit margins widened for investment grade bonds.
- Earnings data in the All Share index has gone haywire (again). The P/E data no longer appears to be terribly reliable.
- [Regulations](#) have now been published to force disclosure by UK occupational DC schemes about charges and trading costs.

Feature Section

This month we update two charts last used in our [April 2013](#) and [November 2013](#) editions, on the UK Equity market's dispersion of returns by company size and their dividend policy. Low dividends are often associated with a Growth bias, and high dividends with a Value bias (although the association is informal, rather than synonymous).

We start below in Figure 1a with the cumulative returns for the FTSE100, FTSE250, FTSE350 and FTSE Small Cap, relative to the All Share (which is kept at 100). This is shown since the split started to be published back in 1994. As the FTSE100 and FTSE350 are dominant parts of the FTSE All Share index (being 80% and 96% respectively as at 31 December 2017), it is not unexpected that they stay pretty close to the 100 level, although it is fair to say that the FTSE100 has now underperformed by about 8% cumulative. It is striking how much persistent difference there is between the FTSE230 and FTSE Small Cap in their returns, as Small Cap is 2% ahead of the All Share but FTSE250 is 78% ahead (which equates to adding about 2.4% p.a. of relative return).

The FTSE350 is the index for the largest 350 companies in the UK. It has been published with a subdivision into high (dividend) yield and low yield since the beginning of 1995. As noted above, sometimes these can be thought of as "value" and "growth" subsets. Stocks move between the two subsets on an annual basis so as to maintain a 50/50 split by market capitalization between the subsets. In Figure 1b, we therefore compare the High Yield and Low Yield halves of the FTSE350, again on a relative basis, this time against the FTSE350 (which is kept at 100).

Figure 1a: UK Equity size effects

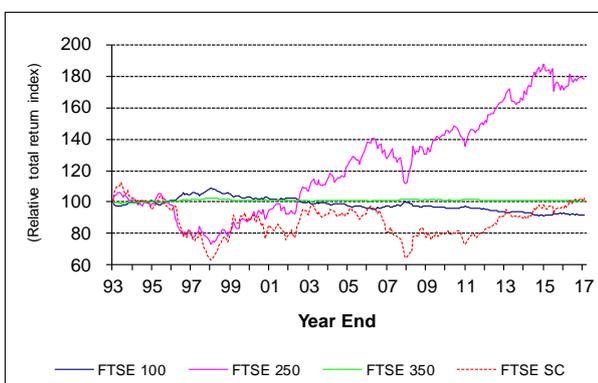
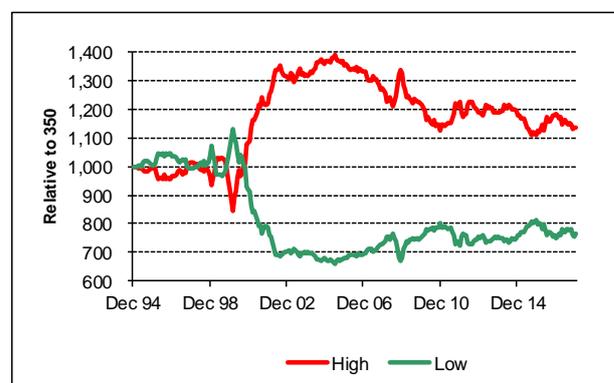


Figure 1b: FTSE350 dividend effects



So, since the early 2000s, backing low-yield and/or FTSE250 would seem to be good strategies within the UK Equity area, but are the strategies sustainable? This month's negative UK Equity return acts as a reminder that equities can go down as well as up. In the event that a more prolonged market downturn is triggered, for example as Quantitative Easing (QE) gets unwound, it will be interesting to see how much of the FTSE250's relative gain gets unwound. Similarly, high yielding stocks may suddenly fare better (as they did in the unwinding of the tech bubble in the early 2000s).

Against this background, the element of downside protection offered (but not guaranteed) by Absolute Return or Diversified Growth funds could come under particular scrutiny (have a look back at our [February 2017](#) issue for previous downturn recovery periods).



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 28 February 2018

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	-3.3	-0.6	4.4	5.9	7.3	6.6	5.4
Overseas Equities	-0.9	1.3	8.1	13.9	13.4	10.6	7.6
US Equities	-0.5	1.3	5.9	15.3	16.9	13.9	6.8
Europe ex UK Equities	-2.5	-0.5	12.8	11.1	10.3	6.7	7.9
Japan Equities	1.6	1.8	10.7	14.9	13.4	8.3	5.0
Pacific ex Japan Equities	-1.6	3.2	13.4	13.1	9.0	9.1	9.6
Emerging Markets	-1.5	5.3	18.3	13.6	7.5	6.8	9.4
UK Long-dated Gilts	0.6	0.0	-1.0	5.9	7.8	8.1	7.2
UK Long-dated Corp. Bonds	-1.6	-0.3	1.1	5.4	7.7	8.2	7.3
UK Over 5 Yrs Index-Linked Gilts	0.4	-0.4	-1.3	8.3	8.1	8.3	7.8
High Yield (Global)	1.9	-1.3	-3.4	10.3	7.3	12.2	7.7
Overseas Bonds	2.7	-1.0	-4.4	6.6	2.8	6.3	5.5
Property *	0.7	3.2	11.2	9.1	11.6	5.8	8.6
Cash	0.0	0.1	0.4	0.5	0.5	1.1	3.1
Commodities £-converted	3.2	2.6	-3.4	-3.4	-10.4	-7.8	0.4
Hedge Funds original \$ basis *	2.5	4.1	10.0	5.1	4.9	3.8	6.7
Illustrative £-converted version *	-2.5	-2.8	-2.7	7.0	7.3	7.3	7.4
Euro relative to Sterling	1.1	0.5	3.7	6.8	0.5	1.5	-
US \$ relative to Sterling	3.2	-1.7	-9.7	3.9	2.0	3.7	0.9
Japanese Yen relative to Sterling	5.6	3.0	-5.3	7.9	-1.0	3.5	1.7
Sterling trade weighted	-1.6	-0.2	1.5	-4.8	-0.2	-1.9	-1.2
Price Inflation (RPI) *	-0.8	0.3	4.0	2.6	2.3	2.8	2.8
Price Inflation (CPI) *	-0.5	0.2	3.0	1.7	1.5	2.4	2.0
Price Inflation (RPIX) *	-0.7	0.2	4.0	2.8	2.4	3.2	2.8
Earnings Inflation **	3.0	2.8	2.8	2.2	2.2	1.8	3.0
All Share Capital Growth	-3.8	-1.3	0.7	2.1	3.5	2.8	2.0
Dividend Growth	-0.9	0.6	9.4	7.7	6.2	3.4	4.3
Earnings Growth	34.3	39.7	96.5	7.0	4.1	0.4	4.0

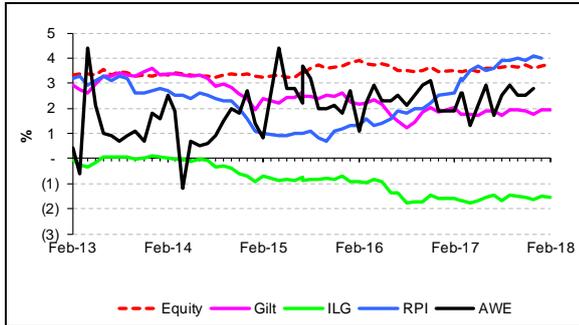
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

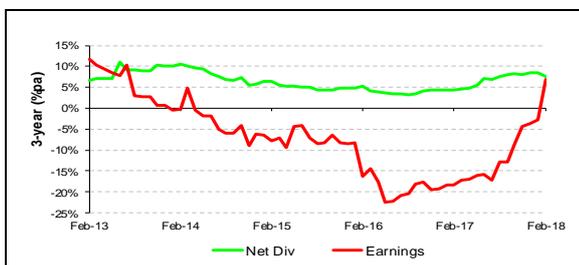
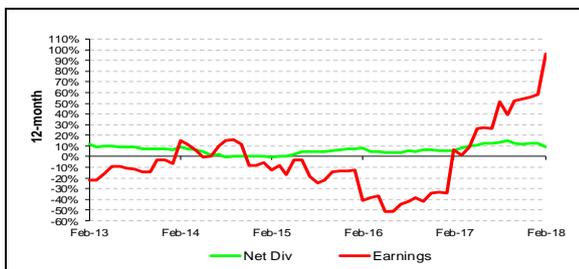


The gap gives a current expectation around 3.5% for longer-term inflation + risk premium for gilts, relative to index-linked gilts.

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]

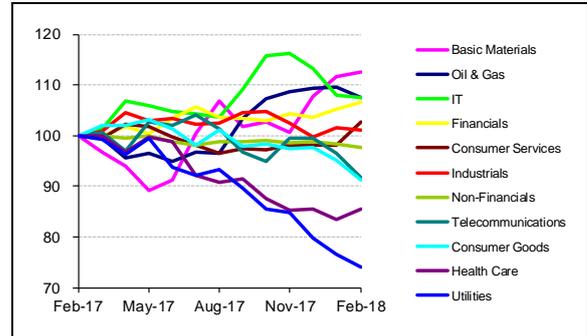
Figure 3: Dividend & Earnings Growth



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



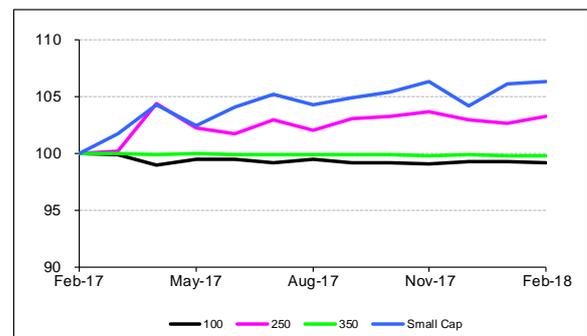
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (from 31% to 39%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-5.1	-1.5	12.3
Basic Materials	-2.5	11.1	17.5
Industrials	-3.8	-1.9	5.5
Consumer Goods	-7.2	-6.9	-4.8
Health Care	-1.0	-0.4	-10.8
Consumer Services	1.4	4.2	7.3
Telecommunications	-8.0	-8.3	-4.3
Utilities	-6.5	-13.3	-22.8
Non-Financials	-3.8	-1.4	2.0
Financials	-1.9	1.5	11.3
IT	-3.7	-8.0	12.3
All Share	-3.3	-0.6	4.4

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

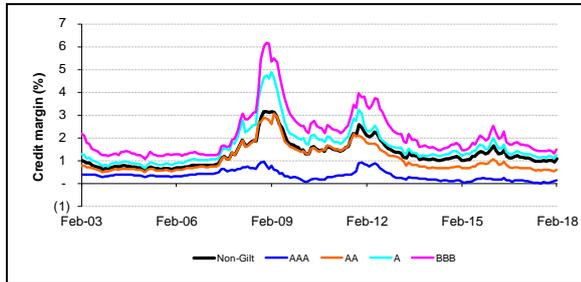


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Sep '17	2.62	1.94	0.68
Oct '17	2.62	1.93	0.69
Nov '17	2.64	1.89	0.75
Dec '17	2.42	1.77	0.65
Jan '18	2.56	1.95	0.61
Feb '18	2.66	1.94	0.72

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

Category	Mkt Val @ Feb 18 & 15, 12			Weight (%)
	Feb 18	Feb 15	Feb 12	
Gilts (41)	1,346	1,198	1,021	70.5
Non Gilts (1,047)	565	544	478	29.5
AAA (131)	110	98	122	5.8
AA (152)	76	92	60	4.0
A (337)	165	182	170	8.7
BBB (427)	213	172	126	11.1

Category	Mkt Val @ Feb 18 & 15		W't (%)	Dur'n (yrs)
Gilts (41)	1,346	1,198	70.5	11.5
< 5 Yrs (12)	399	292	20.9	2.6
5-15 Yrs (11)	360	394	18.8	8.0
> 15 Yrs (18)	587	512	30.7	19.7
Non Gilts (1,047)	565	544	29.5	8.1
< 5 Yrs (365)	184	148	9.6	2.9
5-15 Yrs (449)	234	234	12.2	7.6
> 15 Yrs (233)	147	162	7.7	15.3

£ Gilt Market “main” Issuance

- £2.56bn 1¾% 2057 (1.82x, 1.91%, 13.9%, May 17)
- £0.95bn 1/8% IL 2036 (2.30x, ry -1.51%, 0%, Dec 17)
- £2.75bn 1/8% IL 2048 (5.93x, ry -1.48%, n/a, Nov 17)

Note: Issuance amounts are nominals. The first % figure in each row is the yield or real yield. The second % figure is the additional amount taken up under the Post Auction Option Facility (PAOF), as a % of the amount of the issue. PAOF does not apply for syndication cases.

Tables 2d, 2e: € Market Size and Maturity (Feb 18)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (363)	6,127	60.0
Non Sovereigns	4,082	40.0
AAA (826)	1,158	11.3
AA (639)	997	9.8
A (909)	870	8.5
BBB (1,225)	1,058	10.4

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (904)	2,262	22.2
3 – 5 Yrs (1,022)	2,137	20.9
5 – 7 Yrs (832)	1,695	16.6
7 – 10 Yrs (760)	1,907	18.7
10+ Yrs (444)	2,209	21.6

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Feb 18 & 15)		W't (%)	Dur'n (yrs)
Gilts (28)	648	480	100.0	22.8
< 5 Yrs (3)	59	52	9.1	3.1
5 – 15 Yrs (7)	150	130	23.1	9.4
> 15 Yrs (18)	439	299	67.8	30.0

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

Month End	US (%)	Euro (%)	Sterling (%)
Sep '17	5.21	2.92	5.25
Oct '17	5.22	2.73	5.15
Nov '17	5.39	2.88	5.37
Dec '17	5.45	2.95	5.40
Jan '18	5.48	2.95	5.39
Feb '18	5.75	3.16	5.72

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

