



Investment Update

June 2018

Investment Headlines & Comment

- A relatively muted month for most asset classes.
- Short-dated sterling corporate bond yields rise to a 2-year high.
- US Equities continue to provide astonishing returns.

Feature Section

This month we follow on from our [May 2017](#) and [December 2017](#) editions on ethical investment to consider the recent publication by the Department for Work & Pensions (DWP) of a [consultation](#) on reforming trustees' duties to consider environmental, social and governance (ESG) risks. At first sight, it looks set to have unintended consequences for DC schemes.

The DWP's proposed Regulations are "intended to reassure trustees that they can (and indeed should):

- take account of financially material risks, whether these stem from investee firms' traditional financial reporting, or from broader risks covered in non-financial reporting or elsewhere;
- fulfil the responsibilities associated with holding the investments in members' best interests – whether directly or by others on their behalf - not just through voting, but the full range of stewardship activities, such as monitoring, engagement and sponsoring or co-sponsoring shareholder resolutions;
- have an agreed approach on the extent, if at all, to which they will take account of members' concerns, not only about financially material risks such as ESG, including climate change, but the scheme's investment strategy as a whole; and
- use the SIP as a real, effective and regularly-reviewed guide to investment strategy and not as a generic 'box-ticking' document."

However, most lay Trustees are likely to feel out of their depth commenting on matters such as climate change, and will have to look to their investment managers for guidance, particularly for segregated mandates (where investment constraints could subsequently be put in place). Also, the idea of transforming a SIP from principles into a "strategy guide" for scheme members could be quite an exercise.

The DWP states "the purpose of these proposed regulatory changes is to help dispel trustee confusion, and give institutional investors renewed confidence, if they so choose, to begin or increase the allocation of capital to investment opportunities such as unlisted firms, green finance and social impact investment". They also state "longer-term risks are not necessarily priced into the market. Disruption to underlying asset values may also be rapid and unpredictable".

Page 14 of the DWP consultation has a useful diagram on which schemes are affected (and hence need to start planning). For those (DB and/or DC) schemes required to produce a SIP, two new requirements are proposed

(currently expected to be in place by 1 October 2019). These schemes' Trustees should set out:

- how they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance (ESG) considerations, including climate change
- their policies in relation to the stewardship of the investments, including engagement with investee firms and the exercise of the voting rights associated with the investment

For most schemes with a DC element, two further new requirements are proposed. These schemes should:

- publish their Statement of Investment Principles on a website so that it can be found and read by both scheme members and interested members of the public, and inform scheme members of its availability via the annual benefit statement;
- prepare or update their default strategy to set out how they take account of financially material considerations, including (but not limited to) those arising from Environmental, Social and Governance (ESG) risks, including climate change

Further, when they next review their SIP after 1 October 2019, both DB and DC Trustees are to be asked prepare a "statement on members' views" setting out how they will take account of the views which, in their opinion, members hold, in relation to the matters covered in the SIP. Given how few members currently ask to see their Scheme SIP, this seems a bizarre notion. However, things are set to go further.

From 1 October 2020, if their SIP has been reviewed after 1 October 2019, DC Trustees are to be asked to produce an implementation report setting out how they acted on the principles set out in the SIP, and how they acted on the "statement on members' views", plus publish that implementation report online in the same way as the SIP itself, and inform scheme members of its availability via the annual benefit statement. A rapid shift away from occupational DC into Group Personal Pensions or Mastertrusts looks highly likely!



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 June 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	-0.2	9.2	9.0	9.6	8.8	7.8	5.6
Overseas Equities	0.2	6.7	9.5	15.7	13.5	11.2	7.5
US Equities	1.5	10.0	12.7	18.5	16.6	14.8	6.1
Europe ex UK Equities	0.3	3.3	3.0	12.1	10.4	7.0	7.8
Japan Equities	-1.8	3.2	9.3	13.5	11.3	8.4	5.7
Pacific ex Japan Equities	-3.0	2.3	7.0	13.4	10.6	10.1	11.2
Emerging Markets	-3.3	-2.0	6.8	12.4	8.4	6.9	10.5
UK Long-dated Gilts	-1.0	-0.4	4.2	8.3	9.2	8.9	7.0
UK Long-dated Corp. Bonds	-0.8	-1.4	0.1	7.4	8.1	8.5	6.9
UK Over 5 Yrs Index-Linked Gilts	-0.7	-1.2	2.0	8.5	9.1	8.2	7.5
High Yield (Global)	0.7	4.9	0.4	11.8	8.0	12.3	7.8
Overseas Bonds	0.6	3.3	-0.1	9.2	4.1	6.7	5.6
Property *	0.7	2.3	11.1	8.6	11.8	6.5	8.5
Cash	0.1	0.2	0.5	0.5	0.5	0.9	3.0
Commodities £-converted	2.2	14.8	27.9	1.4	-6.9	-8.7	1.8
Hedge Funds original \$ basis *	0.9	0.8	6.5	3.4	4.2	3.4	6.4
Illustrative £-converted version *	4.5	4.4	2.9	8.2	7.0	7.5	7.5
Euro relative to Sterling	0.8	0.9	0.7	7.7	0.6	1.1	-
US \$ relative to Sterling	0.8	6.2	-1.6	6.0	2.8	4.2	1.2
Japanese Yen relative to Sterling	-1.1	2.0	-0.2	9.6	0.6	3.7	2.3
Sterling trade weighted	-0.2	-1.9	1.0	-5.7	-0.5	-1.8	-1.3
Price Inflation (RPI) *	0.4	0.9	3.3	2.8	2.3	2.7	2.7
Price Inflation (CPI) *	0.4	0.9	2.4	1.9	1.4	2.3	2.0
Price Inflation (RPIX) *	0.4	1.0	3.4	2.9	2.5	3.0	2.8
Earnings Inflation **	-10.0	0.9	2.5	2.3	1.7	1.9	3.0
All Share Capital Growth	-0.5	7.9	5.0	5.6	5.0	3.9	2.2
Dividend Growth	-0.2	2.0	5.9	7.4	5.7	2.8	4.3
Earnings Growth	-0.2	2.1	112.4	9.4	4.9	2.3	4.6

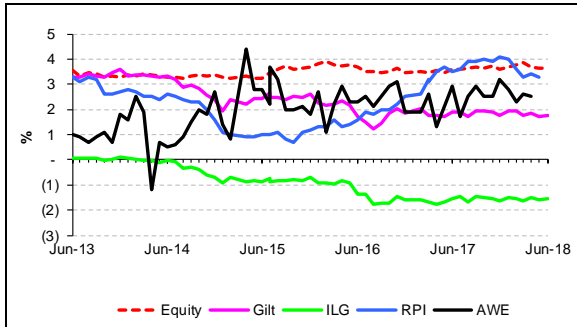
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

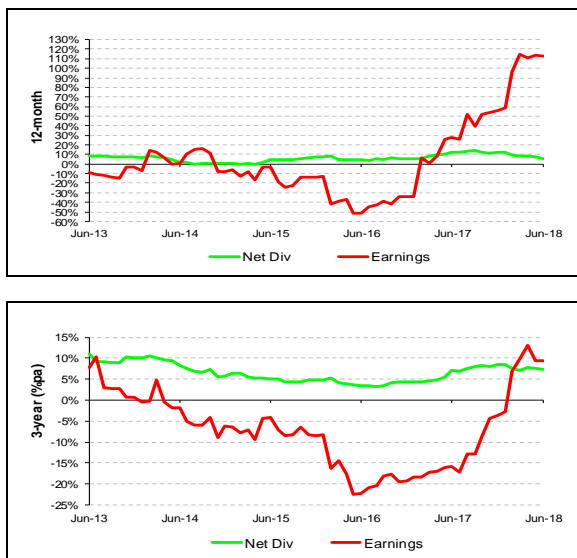


The gap gives a current expectation around 3.3% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

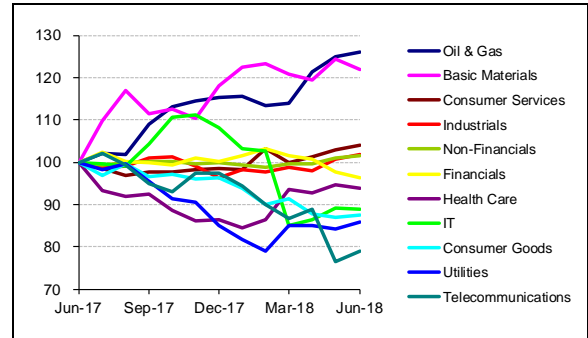
Figure 3: Dividend & Earnings Growth



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



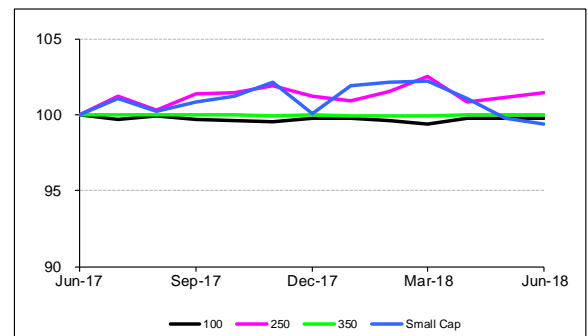
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 51% to 47%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	0.7	20.6	37.3
Basic Materials	-2.2	10.2	32.8
Industrials	1.0	12.5	11.0
Consumer Goods	0.4	4.7	-4.6
Health Care	-1.0	9.8	2.4
Consumer Services	0.9	13.8	13.5
Telecommunications	3.1	-0.5	-13.8
Utilities	1.7	10.1	-6.4
Non-Financials	0.3	11.3	10.5
Financials	-1.6	3.5	4.8
IT	-0.6	14.1	-3.2
All Share	-0.2	9.2	9.0

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap rose but Small Cap fell 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

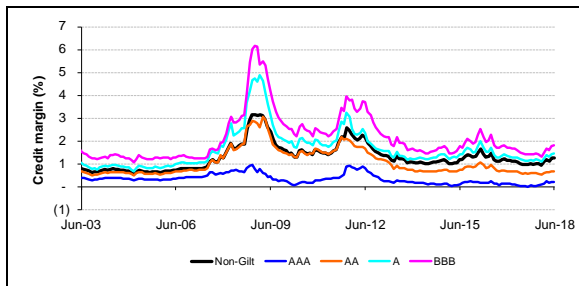


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jan '18	2.56	1.95	0.61
Feb '18	2.66	1.94	0.72
Mar '18	2.56	1.74	0.82
Apr '18	2.65	1.85	0.80
May '18	2.64	1.72	0.92
Jun '18	2.70	1.76	0.94

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

Category	Mkt Val @ Jun 18 & 15, 12			Weight (%)
	Jun 18	Jun 15	Jun 12	
Gilts (42)	1,354	1,190	1,049	70.6
Non Gilts (1,064)	563	531	496	29.4
AAA (136)	111	96	133	5.8
AA (153)	77	96	61	4.0
A (338)	161	165	170	8.4
BBB (437)	214	175	132	11.2

Category	Mkt Val @ Jun 18 & 15		W't (%)	Dur'n (yrs)
Gilts (42)	1,354	1,190	70.6	11.9
< 5 Yrs (11)	358	328	18.7	2.5
5-15 Yrs (12)	379	364	19.8	7.7
> 15 Yrs (19)	616	499	32.2	19.9
Non Gilts (1,064)	563	531	29.4	8.0
< 5 Yrs (374)	183	159	9.5	2.8
5-15 Yrs (454)	234	225	12.2	7.5
> 15 Yrs (236)	146	147	7.6	15.4

£ Gilt Market “main” Issuance

- £2.75bn ¾% 2023 (1.95x, 1.04%, 0%, May 18)
- £2.59bn 1¾% 2037 (2.02x, 1.78%, 15%, Jan 18)
- £1.38bn 1/8% IL 2028 (2.23x, ry -1.71%, 11%, new)

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 (Jun 18)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (361)	6,127	59.6
Non Sovereigns	4,150	40.4
AAA (856)	1,179	11.5
AA (665)	1,035	10.1
A (966)	912	8.9
BBB (1,230)	1,024	10.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (953)	2,272	22.1
3 – 5 Yrs (1,045)	2,177	21.2
5 – 7 Yrs (865)	1,660	16.2
7 – 10 Yrs (778)	1,931	18.8
10+ Yrs (437)	2,236	21.8

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jun 18 & 15)		W't (%)	Dur'n (yrs)
Gilts (29)	662	494	100.0	22.5
< 5 Yrs (3)	59	76	8.9	2.8
5 – 15 Yrs (8)	154	106	23.2	9.1
> 15 Yrs (18)	449	312	67.9	29.7

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

Month End	US (%)	Euro (%)	Sterling (%)
Jan '18	5.48	2.95	5.39
Feb '18	5.75	3.16	5.72
Mar '18	5.99	3.28	5.90
Apr '18	6.00	3.24	5.88
May '18	6.10	3.55	6.10
Jun '18	6.17	3.69	5.69

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

