



## Investment Update

July 2018

### Investment Headlines & Comment

- Another positive month for Equity markets.
- Most bond markets were pretty static this month.
- Strong demand for the new 2041 Index-Linked Gilt.

### Feature Section

This month we look at the investment consulting aspects of the Competition & Markets Authority's (CMA) recent [provisional decision report](#). It puts forward some outline proposals but several of them could be problematic in practice.

The CMA proposes that pension scheme trustees should set strategic objectives for their investment consultant and that the consultant should report on progress in meeting these; with that reporting being done in accordance with agreed standards.

*J&A comment: Investment consultants are advisers, not managers, and it is the trustees who make the decisions, often drawing from a range of options (rather than having a single right answer presented to them). So, the setting of strategic objectives for the consultants (as opposed to specifying services and associated standards) appears a rather tricky task. Wording in section 12.152 suggests this objectives proposal is something on which the CMA thinks the Pensions Regulator can develop guidance. You have to wonder whether anyone at the CMA even had a go on a simple test case to get a sense of the practical problems this will involve. Expect major headaches on this!*

The CMA goes on to suggest that consultants should report the performance of recommended asset management products to an agreed set of standards.

*J&A comment: The notion of recommended products is problematic. True, some firms may say "here is our buy list for asset class X", but that takes no account of any client-specific factors, including the way that an investment might interact with other parts of the client portfolio. For those who don't produce general recommended product lists, would they have to develop such a list on a case-by-case basis with each client, akin to a short-list of managers to be interviewed?*

*Also, is the notion of standardized reporting only being applied ahead of a manager selection exercise, or is it intended for ongoing reporting on client portfolios to be on a standardized basis as well?*

*We also note that the CMA wants to have performance reported on prescribed fee bases. However, this is likely to lead to reports having to contain additional returns information, in order to meet client- or fund-specific circumstances not factored into the prescribed basis (e.g. the client is not on a standard single-figure fee scale, or there is a sliding scale on a pooled fund).*

The CMA goes on to recommend that the Government should extend the FCA's regulatory perimeter to include the "relevant services" provided by investment consultants, and that the Pensions Regulator should develop guidance to support pension trustees in asking for and using the enhanced information they will now be able to access.

*J&A comment: "Relevant services" appears likely to include advice on strategic asset allocation, and manager selection, but it is unclear whether ongoing performance reporting is included or excluded from the proposed extension (it is currently not a regulated activity). It would be interesting to know which investment-related services (if any) the CMA would regard as continuing to be non-regulated.*

*Section 12.149 notes that extending the regulatory perimeter may distort competition and introduce additional regulatory burdens, particularly for smaller firms. Given the CMA says it envisages firms having a single regulatory relationship with the FCA or a DPB (such as applies for J&A, through the Institute and Faculty of Actuaries), the DPB structure looks set to survive. However, the perimeter extension looks set to require all Scheme Actuaries to be regulated for any general asset allocation comment, which seems excessive. Also, the extension may warrant a revision to (or abandonment of) the DPB notion of regulated investment work having to be "incidental" at a firm level, given how much more investment work would be counted within DPB-regulated actuarial firms.*

*It is also unclear how these "relevant services" are to be costed if currently provided as part of a bundled arrangement – will there be an obligation to develop separate fee structures for regulated and non-regulated activities? If some form of the "incidental" test continues for DPB firms, who then determines if the fee splitting has been done fairly?!*

Fortunately, there does not seem to be any desire to introduce compulsory re-tendering of investment consultancy mandates, although market testing can still be done by Trustees to satisfy themselves that their incumbent is meeting their requirements at a fair cost.



**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 July 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	1.3	3.9	9.2	9.2	7.7	8.3	5.7
Overseas Equities	3.9	8.0	12.3	16.6	13.3	11.9	7.6
US Equities	4.2	<b>12.1</b>	<b>16.9</b>	<b>19.1</b>	<b>16.3</b>	<b>15.4</b>	6.1
Europe ex UK Equities	<b>5.1</b>	4.6	6.3	12.4	9.9	7.7	8.0
Japan Equities	1.0	1.7	10.0	13.4	11.4	8.8	5.7
Pacific ex Japan Equities	2.1	1.4	5.9	15.9	10.6	10.5	<b>11.4</b>
Emerging Markets	2.9	<b>-0.6</b>	5.3	15.9	8.7	7.6	10.3
UK Long-dated Gilts	<b>-0.6</b>	1.2	3.4	7.0	8.9	8.5	6.9
UK Long-dated Corp. Bonds	0.2	<b>-0.3</b>	<b>-0.4</b>	6.5	7.6	8.3	6.9
UK Over 5 Yrs Index-Linked Gilts	0.5	2.3	4.0	7.6	9.1	8.2	7.4
High Yield (Global)	2.0	5.0	2.3	12.4	8.0	12.7	7.8
Overseas Bonds	0.1	3.3	<b>-0.1</b>	8.8	3.9	6.7	5.5
Property *	0.8	2.2	10.9	8.4	11.8	6.7	8.5
Cash	0.1	0.2	0.5	<b>0.5</b>	<b>0.5</b>	<b>0.9</b>	<b>3.0</b>
Commodities £-converted	<b>-2.9</b>	4.2	20.6	5.3	<b>-8.3</b>	<b>-7.8</b>	2.0
Hedge Funds original \$ basis *	<b>-0.4</b>	0.9	5.7	3.7	4.5	3.5	6.4
Illustrative £-converted version *	0.3	7.2	4.0	9.9	7.4	7.8	7.6
Euro relative to Sterling	0.9	1.7	<b>-0.3</b>	8.0	0.4	1.3	-
US \$ relative to Sterling	0.6	5.0	0.5	6.0	2.9	4.2	1.1
Japanese Yen relative to Sterling	<b>-0.4</b>	2.6	<b>-0.8</b>	9.6	0.3	3.8	2.4
Sterling trade weighted	<b>-0.5</b>	<b>-2.0</b>	1.1	<b>-6.2</b>	<b>-0.4</b>	<b>-1.8</b>	<b>-1.2</b>
Price Inflation (RPI) *	0.3	1.1	3.4	2.8	2.4	2.6	2.8
Price Inflation (CPI) *	0.0	0.8	2.4	1.8	1.5	2.2	2.0
Price Inflation (RPIX) *	0.3	1.2	3.4	3.0	2.5	3.0	2.8
Earnings Inflation **	<b>-0.9</b>	<b>-2.6</b>	2.4	2.3	2.1	1.8	3.0
All Share Capital Growth	1.2	3.0	5.1	5.2	3.9	4.5	2.2
Dividend Growth	<b>-0.2</b>	0.3	5.7	7.2	5.6	2.7	4.2
Earnings Growth	3.4	5.5	123.5	16.1	7.0	2.6	4.8

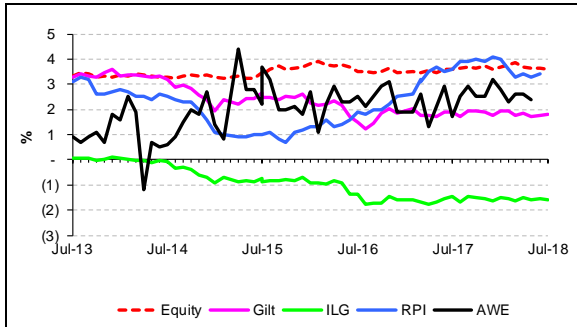
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

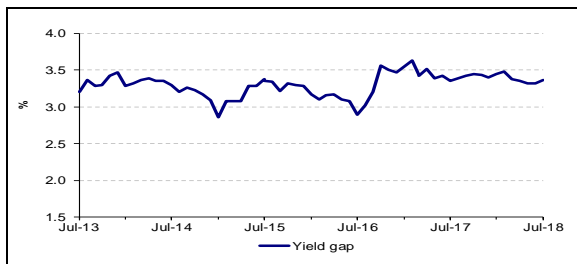


## Yields and Yield Gaps

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.

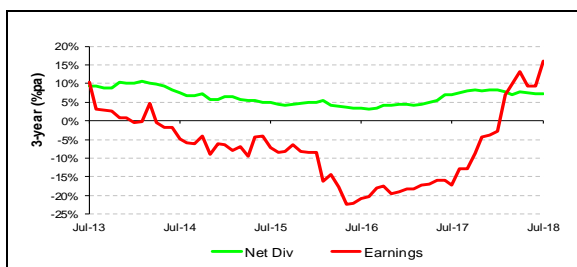
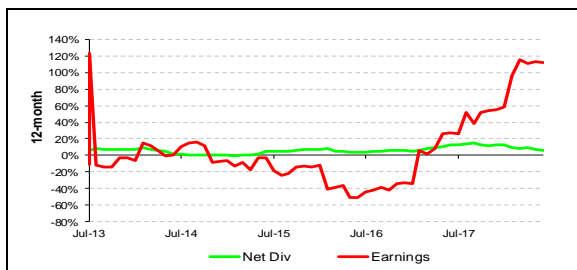


The gap gives a current expectation around 3.4% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

## 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]

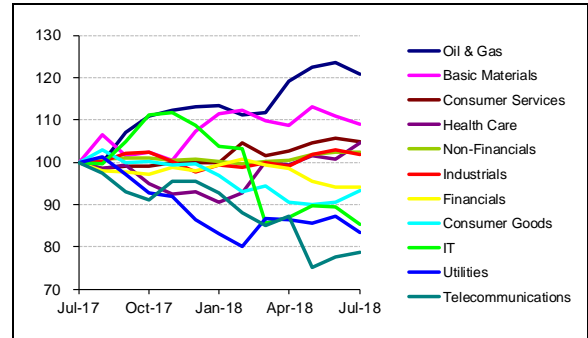
Figure 3: Dividend & Earnings Growth



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



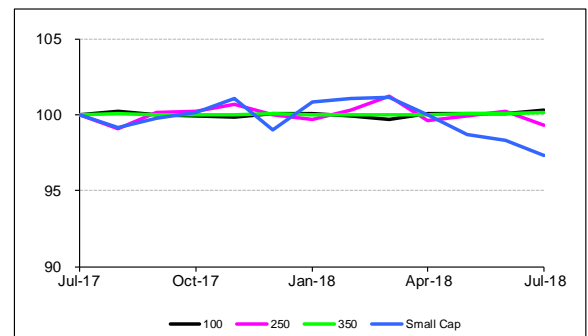
Note: Sector labels for relative lines are in end-value order

There was a fall this month in the rolling 12-month sector dispersion (from 47% to 42%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-0.9	5.5	31.8
Basic Materials	-0.3	4.3	19.0
Industrials	0.2	6.9	11.2
Consumer Goods	4.6	7.2	1.9
Health Care	4.9	9.1	14.0
Consumer Services	0.5	6.1	14.4
Telecommunications	2.8	-6.1	-14.1
Utilities	-3.2	0.2	-8.9
Non-Financials	1.3	5.7	11.6
Financials	1.3	-0.8	2.7
IT	-3.4	1.8	-7.1
All Share	1.3	3.9	9.2

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



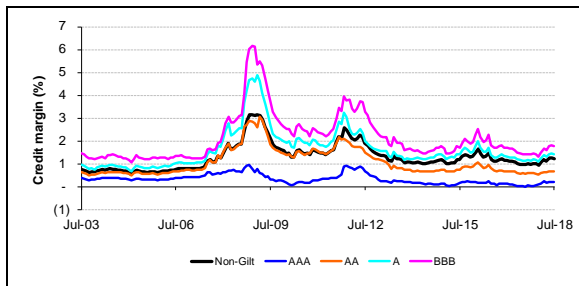
Mid Cap and Small Cap both fell in relative terms this month.

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 (%)
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
Jul '18	<b>2.70</b>	<b>1.79</b>	<b>0.91</b>

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

Category	Mkt Val @ Jul 18 & 15, 12			Weight (%)
	Jul 18	Jul 15	Jul 12	
Gilts (42)	1,350	1,214	1,080	70.6
Non Gilts (1,068)	563	542	516	29.4
AAA (137)	112	99	138	5.8
AA (157)	79	96	64	4.1
A (341)	161	166	171	8.4
BBB (433)	212	180	143	11.1

Category	Mkt Val @ Jul 18 & 15		W't (%)	Dur'n (yrs)
Gilts (42)	1,350	1,214	70.6	11.8
< 5 Yrs (11)	357	328	18.7	2.4
5-15 Yrs (12)	381	370	19.9	7.6
> 15 Yrs (19)	613	516	32.0	19.8
Non Gilts (1,068)	563	542	29.4	8.0
< 5 Yrs (377)	185	161	9.7	2.8
5-15 Yrs (454)	233	231	12.2	7.4
> 15 Yrs (237)	145	150	7.6	15.3

**£ Gilt Market “main” Issuance**

- £2.75bn 1% 2024 (2.13x, 1.09%, 0%, new)
- £2.87bn, 1<sup>5</sup>/<sub>8</sub>% 2028 (2.30x, 1.43%, 15%, May 18)
- £2.30bn 1<sup>3</sup>/<sub>4</sub>% 2057 (1.74x, 1.60%, 15%, Apr 18)
- £3.25bn 1<sup>1</sup>/<sub>8</sub>% IL 2041 (6.34x, ry -1.62%, n/a, 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 (Jul 18)**

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (360)	6,167	59.7
Non Sovereigns	4,171	40.3
AAA (867)	1,189	11.5
AA (667)	1,036	10.0
A (971)	909	8.8
BBB (1,242)	1,037	10.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (956)	2,273	22.0
3 – 5 Yrs (1,064)	2,188	21.2
5 – 7 Yrs (867)	1,697	16.4
7 – 10 Yrs (784)	1,916	18.5
10+ Yrs (436)	2,264	21.9

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

Category (Number of issues)	Mkt Val (£bn @ Jul 18 & 15)		W't (%)	Dur'n (yrs)
Gilts (30)	669	482	100.0	22.5
< 5 Yrs (3)	59	50	8.8	2.7
5 – 15 Yrs (8)	153	124	22.9	9.0
> 15 Yrs (19)	457	308	68.3	29.6

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Jul '18	<b>6.06</b>	<b>3.51</b>	<b>5.65</b>

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

