



## Investment Update January 2019

### Investment Headlines & Comment

- The **US Federal Reserve** has indicated that further rate rises are less likely.
- Many **equity markets** have recovered their December 2018 losses (ahead of the Fed news).
- Similarly, the yields on **High Yield bonds** fell back after their December spike.

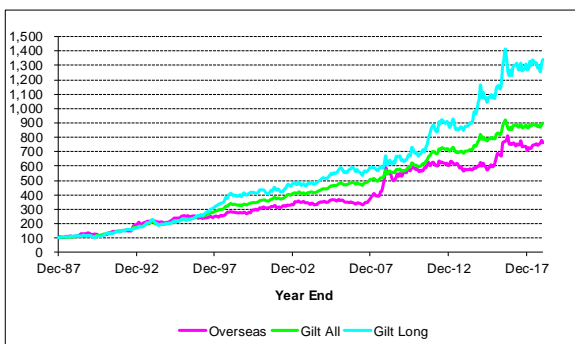
### Feature Section

This month we consider the profile of government debt across the World's developed markets. It seems we last wrote on this in the [January 2008](#) edition, so a "then and now" comparison should be interesting, particularly given the intervening "credit crunch".

Figure 1a looks at longer-term total returns data, shows the cumulative returns for UK and Overseas bonds since the end of 1987 – the long-run annualized numbers are 6.7% p.a. for Overseas, 7.3% p.a. for UK (and 8.7% p.a. for long-dated UK). Incidentally, the chart makes clear just how much the divergence between all- and long-dated UK returns has been focused in the last decade with the collapse of long-term interest rates.

Back at the end of January 2008, the main JP Morgan Global Bond Index had a market capitalization of US \$11.94trn. At the end of January 2019, that figure has increased to US \$24.15trn. A major constituent of that has been the almost 300% increase in US Government debt (coming through yield falls as well as issuance), which has pushed its weighting above Japan (who had the largest debt back in 2008), where the expansion has been by only 35%. For the UK, the expansion has been by 137%, and the biggest Eurozone expansion has been in Spain, up by 198%. Figure 1b shows the overall profile, with over 75% across the top 5 countries. Figure 1c shows the maturity profile across the main index constituents.

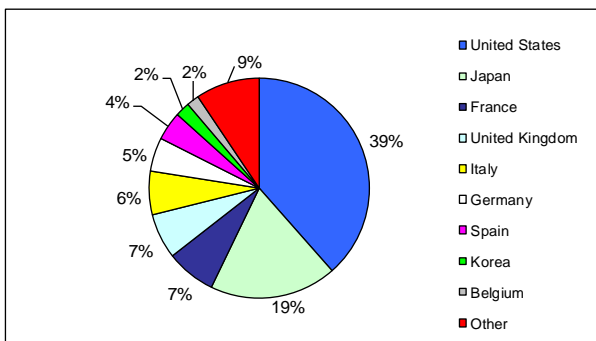
**Figure 1a: Cumulative Total Returns**



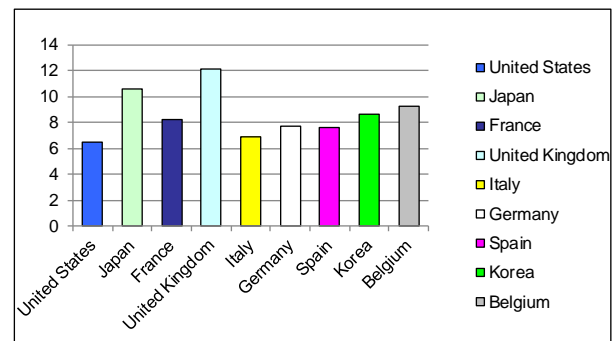
The UK continues to have the longest maturity profile of all, but there has been a considerable increase since 2008 in the maturity profile for the Japanese market. By contrast, there has been relatively little change in the maturity profile for the US market, now broadly half that of the UK.

Looking at the 10-year yields for various markets, Japanese debt is at a redemption yield of 0.01% p.a., German debt at 0.08% p.a., both of which ought to prompt questions, whereas US debt at 2.71% p.a. seems comparatively "normal"

**Figure 1b: Split by Market Cap at 31 Jan 19**



**Figure 1c: Gov't Bond Durations at 31 Jan 19**



Sources for all charts: JP Morgan, Financial Times

Looking at 5-year debt for Japan and Germany shows negative yields, which used to be thought a fundamentally undesirable feature of interest rate models, yet is a reality. It should all be rather concerning ...



**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 January 2019**

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	4.2	-1.4	-3.8	8.7	5.6	10.2	5.2
Overseas Equities	4.4	-1.1	0.6	15.5	12.7	13.2	6.9
US Equities	4.7	-2.6	5.5	17.1	<b>15.8</b>	<b>16.1</b>	5.7
Europe ex UK Equities	3.4	-1.9	-7.3	11.1	7.4	9.9	7.0
Japan Equities	2.7	-3.4	-4.5	11.8	10.7	8.1	4.8
Pacific ex Japan Equities	3.6	5.7	-6.4	16.3	10.8	13.0	10.1
Emerging Markets	<b>5.3</b>	<b>7.2</b>	-6.9	<b>18.3</b>	9.9	11.0	<b>10.8</b>
UK Long-dated Gilts	2.1	3.5	5.6	5.7	8.9	8.3	6.1
UK Long-dated Corp. Bonds	3.5	2.6	0.4	6.9	7.4	9.1	6.3
UK Over 5 Yrs Index-Linked Gilts	0.7	-0.3	3.2	7.5	9.1	8.6	6.9
High Yield (Global)	0.8	-1.0	7.3	11.8	8.7	12.0	7.9
Overseas Bonds	-2.1	1.3	7.7	5.2	5.7	3.1	5.1
Property *	0.3	1.1	7.5	7.0	10.8	9.1	8.4
Cash	0.1	0.2	0.8	<b>0.5</b>	<b>0.5</b>	<b>0.7</b>	<b>2.8</b>
Commodities £-converted	5.5	-13.4	1.6	8.0	-8.8	-3.2	2.1
Hedge Funds original \$ basis *	-2.4	-5.9	-4.6	3.0	2.2	4.9	6.1
Illustrative £-converted version *	-2.2	-3.6	1.3	8.1	7.7	6.4	7.6
Euro relative to Sterling	-2.8	-1.6	-0.4	4.6	1.2	-0.2	1.2
US \$ relative to Sterling	-3.2	-2.9	8.1	2.5	4.5	0.9	1.1
Japanese Yen relative to Sterling	-2.4	0.7	8.4	6.3	3.2	-1.0	1.5
Sterling trade weighted	2.5	1.4	-1.2	-3.7	-1.7	0.0	-1.0
Price Inflation (RPI) *	0.4	0.5	2.7	3.1	2.4	3.0	2.8
Price Inflation (CPI) *	0.1	0.5	2.1	2.2	1.5	2.3	2.0
Price Inflation (RPIX) *	0.4	0.5	2.7	3.2	2.5	3.2	2.9
Earnings Inflation **	-1.1	-0.1	3.2	2.9	2.5	1.9	3.0
All Share Capital Growth	4.1	-2.0	-7.5	4.7	1.8	6.3	1.8
Dividend Growth	0.1	4.1	8.1	8.7	6.8	5.1	4.6
Earnings Growth	1.9	-1.6	57.2	18.1	6.3	3.0	4.9

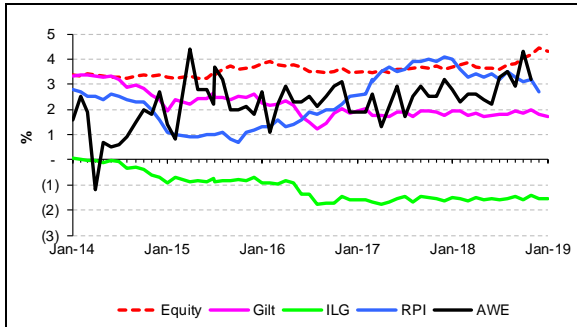
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

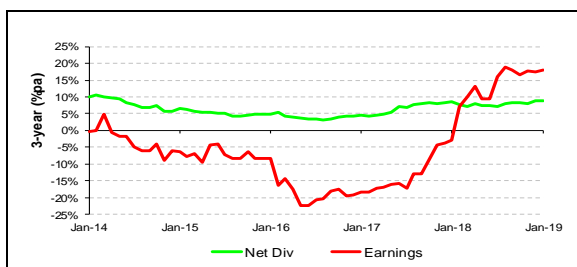
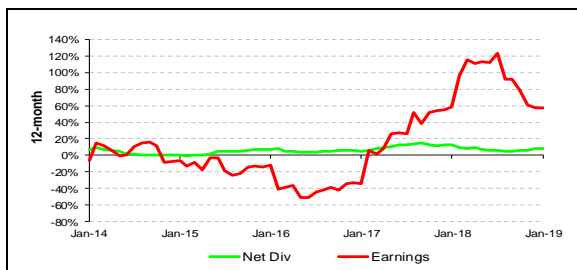


The gap gives a current expectation around 3.3% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

## 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]

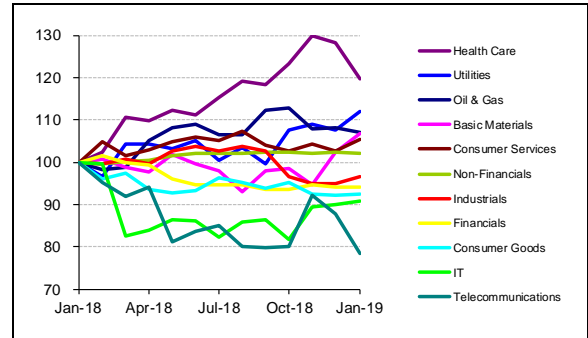
Figure 3: Dividend & Earnings Growth



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



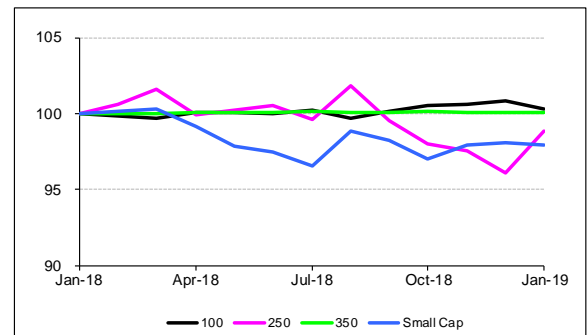
Note: Sector labels for relative lines are in end-value order

There was little change this month in the rolling 12-month sector dispersion (from 40% to 41%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	3.2	-6.2	3.0
Basic Materials	8.9	7.0	2.7
Industrials	6.0	-1.5	-7.1
Consumer Goods	4.5	-4.1	-11.0
Health Care	-2.9	-4.3	15.0
Consumer Services	7.1	1.4	1.4
Telecommunications	-6.8	-3.4	-24.6
Utilities	8.5	2.8	7.7
Non-Financials	4.2	-1.6	-1.7
Financials	4.3	-0.7	-9.5
IT	4.9	9.5	-12.8
All Share	4.2	-1.4	-3.8

## UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap rose in relative terms this month, but Small Cap fell very slightly.

Sources for charts on this page:  
Financial Times, Office for National Statistics, J&A



Bond market information

Figure 5: £ Non-Gilt Credit Margins

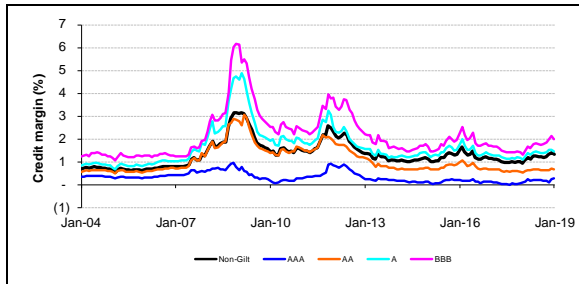


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Aug '18	2.66	1.79	0.87
Sep '18	2.79	1.93	0.86
Oct '18	2.74	1.86	0.88
Nov '18	2.96	2.00	0.96
Dec '18	2.75	1.81	0.94
Jan '19	<b>2.55</b>	<b>1.71</b>	<b>0.84</b>

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

Category	Mkt Val @ Jan 19 & 16, 13			Weight (%)
	Jan 19	Jan 16	Jan 13	
Gilts (42)	1,339	1,261	1,092	70.4
Non Gilts (1,072)	563	522	523	29.6
AAA (140)	111	97	127	5.8
AA (163)	81	93	73	4.3
A (318)	152	155	176	8.0
BBB (451)	219	176	148	11.5

Category	Mkt Val (£bn @ Jan 19 & 16)	W't (%)	Dur'n (yrs)
Gilts (42)	1,339 1,261	70.4	12.1
< 5 Yrs (11)	350 353	18.4	2.6
5-15 Yrs (11)	351 393	18.5	7.7
> 15 Yrs (20)	638 515	33.5	19.7
Non Gilts (1,072)	563 522	29.6	7.9
< 5 Yrs (380)	188 150	9.9	2.8
5-15 Yrs (459)	234 227	12.3	7.4
> 15 Yrs (233)	141 144	7.4	15.4

Tables 2d, 2e: € Market Size and Maturity (Jan 19)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (355)	6,238	59.2
Non Sovereigns	4,293	40.8
AAA (889)	1,215	11.5
AA (712)	1,083	10.3
A (993)	908	8.6
BBB (1,320)	1,087	10.3

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,009)	2,339	22.2
3 – 5 Yrs (1,141)	2,245	21.3
5 – 7 Yrs (887)	1,762	16.7
7 – 10 Yrs (785)	1,876	17.8
10+ Yrs (447)	2,309	21.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jan 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (30)	678	499	100.0	21.8
< 5 Yrs (3)	59	50	8.7	2.2
5 – 15 Yrs (8)	159	126	23.5	8.6
> 15 Yrs (19)	460	323	67.9	28.9

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

Month End	US (%)	Euro (%)	Sterling (%)
Aug '18	6.02	3.61	5.68
Sep '18	6.02	3.58	5.78
Oct '18	6.45	3.91	5.84
Nov '18	6.71	4.37	6.37
Dec '18	7.26	4.46	6.77
Jan '19	<b>6.42</b>	<b>4.05</b>	<b>6.36</b>

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

£ Gilt Market “main” Issuance

- o £2.80bn, 1% 2024 (2.22x, 1.02%, 12%, Dec '18)
- o £2.56bn, 1<sup>5</sup>/<sub>8</sub>% 2028 (2.17x, 1.27%, 14%, Nov '18)
- o £2.01bn, 1<sup>3</sup>/<sub>4</sub>% 2037 (2.28x, 1.77%, 15%, Nov '18)

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.

