



Investment Headlines & Comment

- A muted month for gilts.
- Most equity markets rose.
- A slight rise in Sterling.

Feature Section

This month we have a guest item from Jae Fassam at Pinsent Masons, on whether *Cowan v Scargill* [1985] Ch. 270 is still relevant to trustees when considering ESG factors in investment. The *Cowan* case concerned a dispute between the trustees of a mineworkers' pension scheme. Five trustees refused the approval of an investment plan unless it was amended to prohibit investments in overseas companies or in oil or gas. The main reason for the objection was that investments would damage the UK coal industry and this would be against the beneficiaries' interests. It was held that trustees must exercise their powers in the beneficiaries' best financial interests as members of the scheme. Therefore, there was a breach of fiduciary duty by the trustees as the exclusion of certain investments was contrary to the beneficiaries' best interests.

The *Cowan* decision has often been oversimplified to be read as making the "proper purpose" of trustees to invest to maximise returns at any cost. The *Cowan* judgment itself is more sophisticated in its reasoning with *Megarry VC* making clear that investment returns must be judged "in relation to the risks of the investment in question; and the prospects of the yield and income and capital appreciation both have to be considered in judging the return from the investment."

A similar case heard in the Scottish Courts (*Martin v City of Edinburgh District Council* [1989] Pens LR 9) held that a decision by trustees to disinvest funds from South Africa to ensure alignment with Edinburgh Council's apartheid-free policy was a breach of fiduciary duty. However, the breach was due to the decision being taken in the wrong way. In other words, the starting point was the Council's policy on apartheid and not the best interests of the beneficiaries. However, in the *Martin* judgment the Court accepted that the impact of actual or potential unrest in South Africa on the value of those investments could be an acceptable basis for a decision to disinvest and this sits well with the focus of *Megarry VC* on the need to balance risk and return.

Lord Murray in *Martin* also emphasises the special role that trustees have: "I accept that the most profitable investment of funds is one of a number of matters which trustees have a duty to consider. But I cannot conceive that trustees have an unqualified duty ... simply to invest trust funds in the most profitable investment available. To accept that without qualification would, in my view, involve substituting the discretion of financial advisers for the discretion of trustees".

It is not safe to draw from *Cowan* or from *Martin* the principle that trustees have a duty to seek return at any cost. Alternatively, trustees must exercise their power of investment for its proper purpose (i.e. to provide pensions for beneficiaries) and not for an ulterior (e.g. political) purpose. This characterisation gives a much broader scope to trustees' investment powers compared to merely seeking "returns at any costs" and, crucially, requires long-term risks to be taken into account.

The UNEP FI report from as long ago as 2005 made these points, although the trustee advisory world has been slow to pick up on the correct interpretation of *Cowan*, particularly when grappling with ESG and, more lately, with "impact" investment. Indeed the 2014 Law Commission report on '*Fiduciary Duties of Investment Intermediaries*', specifically targets the "returns at any costs" myth and promotes in its place the wider interpretation that a trustee's fiduciary duty is to promote the purpose of the trust.

A further hangover from *Cowan* is the secondary status that has been afforded to "non-financial" factors in investments which has led to non-financial factors being downplayed or treated in a "tick-box" way in investment strategies. It is true that the Courts in both *Cowan* and *Martin* found against the concept of trustees taking into account non-financial factors when exercising powers of investment. However, the Courts in those cases did not take issue necessarily with non-financial factors. Rather, the potential breach of duty arose because consideration of the specific "factor" in question (e.g. anti-apartheid policy, employment in the UK mining industry and promotion of a church's position on ethics) fell outside of the purpose of the investment power that had been given to the trustees. So, case law establishes that non-financial factors are entirely valid when assessing investments. This follows from the decision in *Cowan* on the need for trustees to judge investment returns in relation to risks.

Most Trustees are required to have a Statement of Investment Principles which sets out how they will take into account financially material considerations – including guidance on considering exposure to long-term financial risk such as climate change. Separately, the reporting that is coming through from bodies engaged in building indices to measure ESG factors, as well as the science and lived experience on many ESG factors (e.g. climate change and diversity on corporate boards) suggests that the label "non-financial" factor is no longer relevant. To the extent *Cowan* should ever have been relevant, these developments and, in particular, continued statutory intervention, will make the existing case law (and *Cowan* in particular) less relevant to trustees' decision-making processes.



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 November 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	2.2	3.8	11.0	7.4	6.5	8.2	4.9
Overseas Equities	2.5	1.3	12.8	11.4	12.4	12.1	6.7
US Equities	3.8	1.7	14.7	13.6	15.2	16.1	6.1
Europe ex UK Equities	1.4	1.0	14.2	10.9	9.1	8.1	7.4
Japan Equities	0.6	3.5	7.4	7.6	11.7	9.5	2.7
Pacific ex Japan Equities	0.6	0.3	8.3	7.9	8.9	8.5	8.9
Emerging Markets	-0.1	-0.1	6.2	8.2	7.5	6.2	8.5
UK Long-dated Gilts	-1.3	-3.4	20.1	7.0	7.8	8.5	6.7
UK Long-dated Corp. Bonds	-0.4	-1.3	21.9	7.5	7.5	8.4	7.1
UK Over 5 Yrs Index-Linked Gilts	-1.9	-8.0	11.8	4.9	7.3	8.4	7.2
High Yield (Global)	0.3	-4.4	8.6	5.2	9.1	9.8	8.1
Overseas Bonds	-1.1	-8.1	6.7	2.4	6.1	4.0	5.5
Property *	0.2	0.6	2.5	7.5	7.9	9.8	7.9
Cash	0.1	0.2	0.8	0.6	0.6	0.6	2.6
Commodities £-converted	0.0	-3.0	0.0	0.5	-4.8	-3.7	0.6
Hedge Funds original \$ basis *	0.6	-0.3	4.3	4.2	3.1	4.1	5.7
Illustrative £-converted version *	-4.2	-5.6	3.0	2.2	7.6	6.6	7.0
Euro relative to Sterling	-1.1	-5.7	-3.9	0.1	1.4	-0.7	1.5
US \$ relative to Sterling	0.0	-5.9	-1.4	-1.1	3.9	2.4	1.0
Japanese Yen relative to Sterling	-1.2	-8.7	2.3	0.2	5.6	0.0	0.7
Sterling trade weighted	0.8	5.9	3.3	0.9	-1.6	0.0	-1.1
Price Inflation (RPI) *	-0.2	0.3	2.1	3.1	2.4	3.0	2.8
Price Inflation (CPI) *	-0.2	0.4	1.5	2.3	1.5	2.2	2.0
Price Inflation (RPIX) *	-0.2	0.3	2.1	3.2	2.5	3.1	2.9
Earnings Inflation **	0.4	-1.3	3.6	3.1	2.8	2.2	3.0
All Share Capital Growth	1.8	2.9	6.4	3.3	2.5	4.4	1.4
Dividend Growth	-0.1	0.5	7.6	8.4	7.6	6.8	4.6
Earnings Growth	-3.3	-3.5	-23.6	23.7	1.5	5.2	3.8

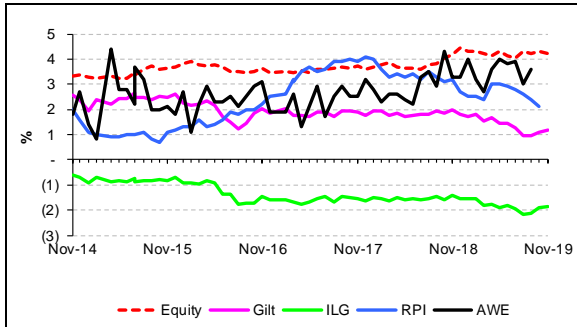
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- UK Equities (incl. dividends and earnings) – FT-A All Share.
- Overseas Equities (incl. regions) – blend of FT All-World / World sub-indices
- 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 – MLX 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.

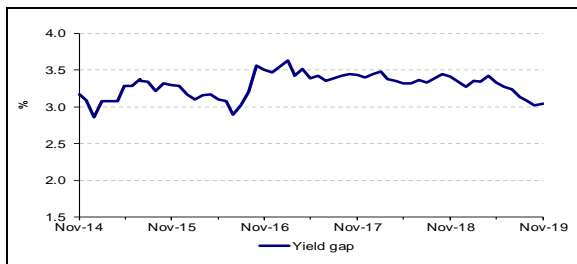


Yields and Yield Gaps

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.

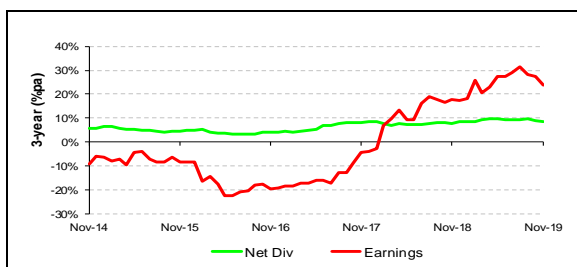
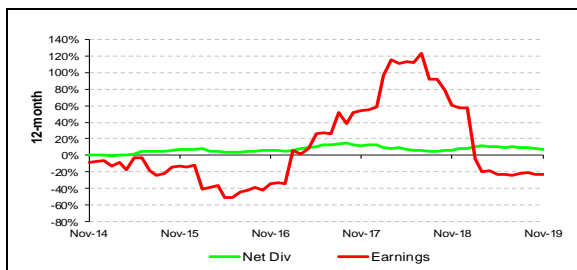


The gap gives a current expectation around 3.0% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

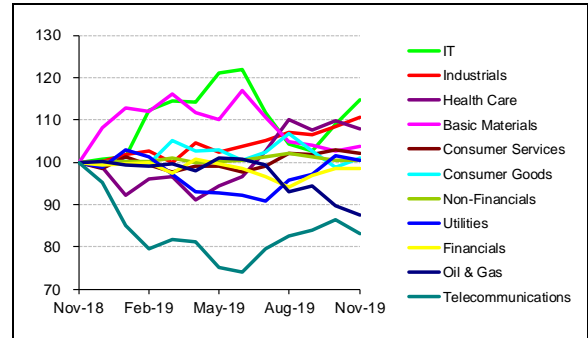
Figure 3: Dividend & Earnings Growth



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



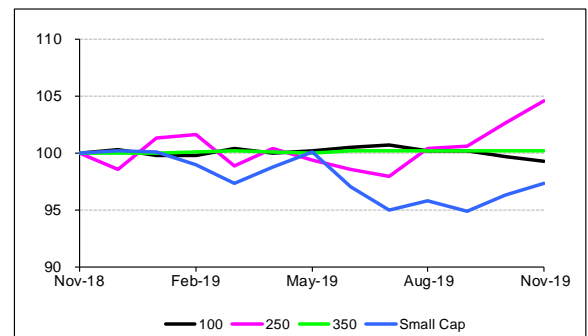
Note: Sector labels for relative lines are in end-value order

There was a slight fall this month in the rolling 12-month sector dispersion (from 34% to 32%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-0.2	-2.4	-2.9
Basic Materials	3.3	2.6	15.2
Industrials	4.2	7.2	22.7
Consumer Goods	4.7	-1.8	12.2
Health Care	0.6	1.7	19.8
Consumer Services	1.3	3.7	13.2
Telecommunications	-1.6	4.6	-7.7
Utilities	1.1	9.0	11.6
Non-Financials	2.2	2.1	11.6
Financials	2.3	8.8	9.4
IT	7.5	14.2	27.4
All Share	2.2	3.8	11.0

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap and Small Cap both 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

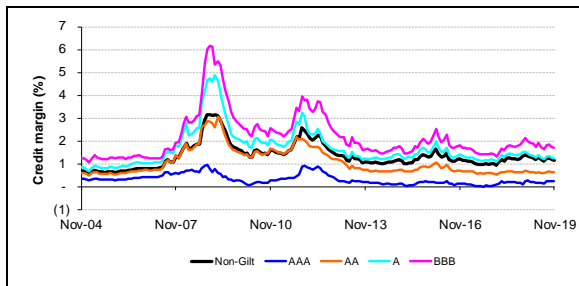


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Jun '19	2.24	1.44	0.80
Jul '19	2.08	1.27	0.81
Aug '19	1.80	0.97	0.83
Sept '19	1.80	0.95	0.85
Oct '19	1.91	1.10	0.81
Nov '19	1.94	1.18	0.76

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

Category	Mkt Val @ Nov 19 & 16, 13			Weight (%)
	Nov 19	Nov 16	Nov 13	
Gilts (42)	1,401	1,316	1,071	68.5
Non Gilts (1,161)	644	552	523	31.5
AAA (159)	133	108	106	6.5
AA (173)	89	92	85	4.3
A (354)	180	169	165	8.8
BBB (475)	242	183	167	11.8

Category	Mkt Val (£bn @ Nov 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (42)	1,401	1,316	68.5	13.1
< 5 Yrs (10)	311	378	15.2	2.7
5-15 Yrs (12)	403	350	19.7	8.0
> 15 Yrs (20)	688	588	33.6	20.7
Non Gilts (1,161)	644	552	31.5	7.9
< 5 Yrs (414)	213	165	10.4	2.6
5-15 Yrs (513)	278	230	13.6	7.4
> 15 Yrs (234)	153	157	7.5	16.2

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (364)	6,715	58.5
Non Sovereigns	4,762	41.5
AAA (946)	1,290	11.2
AA (767)	1,177	10.3
A (1,137)	1,039	9.1
BBB (1,515)	1,256	10.9

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,147)	2,489	21.7
3 – 5 Yrs (1,257)	2,331	20.3
5 – 7 Yrs (952)	1,878	16.4
7 – 10 Yrs (817)	1,942	16.9
10+ Yrs (556)	2,838	24.7

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Nov 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (29)	740	594	100.0	21.8
< 5 Yrs (4)	94	34	12.7	3.0
5 – 15 Yrs (7)	154	143	20.8	10.0
> 15 Yrs (18)	493	417	66.6	29.0

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

Month End	US (%)	Euro (%)	Sterling (%)
Jun '19	5.68	3.27	5.51
Jul '19	5.66	3.22	5.57
Aug '19	5.60	3.10	5.52
Sept '19	5.49	3.11	5.48
Oct '19	5.54	3.17	5.38
Nov '19	5.45	3.08	5.25

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

£ Gilt Market "main" Issuance

- o £3.45bn, ⁵/₈% 2025 (2.16x, 0.49%, 15%, Oct 19)
- o £2.82bn, ⁷/₈% 2029 (2.58x, 0.74%, 3%, Oct 19)
- o £2.36bn, 1³/₄% 2049 (1.67x, 1.25%, 5%, Aug 19)
- o £2.25bn IL ¹/₈% 2041 (7.82x, ry -1.88%, n/a, Jul 19)

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.

