



Investment Headlines & Comment

- A poor month for many equity markets in local terms, and also for Sterling as a currency.
- German 10-year yields hit a month-end low of *minus* 0.27% whilst Italy is still up at 2.39%.
- The new **2054 gilt**'s £32bn of offers is second only to £37.8bn in May 2018 (the 2071 issue).

Feature Section

This month we return to some aspects of our [February 2019](#) feature, which prompted an independent Trustee to ask whether the gilt re-issuance was just a continuation of what had been happening when a budget deficit existed. We suggested the scale of it was rather different, and in this issue we outline the data that demonstrates this.

First, a reminder of the relevant comment. We mused on “*the prospective scale of future gilt issuance putting upward pressure on yields. For example, a quarter of the Gilt market matures in the next 5 years and will have to be reissued; there is an ongoing Budget deficit to finance; the Quantitative Easing portfolio may well be unwound at some point; and there is the possibility of a surge in Government spending if Mr Corbyn gets elected. LDI advocates claim that pension scheme demand will offset this risk of rising yields, but this may rather rely on the madness of crowds.*”

Figure 1a shows the market values of various sections of the UK bond market over time, and for each time point the sum of the next 5 years’ Government borrowing (“PSNB”) – the most recent values include use of OBR projections for the 2019/20 year and beyond. The Index-Linked Gilt (ILG) dataset does not go quite back to the start of the chart, but this is not significant. Figure 1b shows the same data, all inflated (using RPI) to 2019 prices, to see whether the perceptions are any different once inflation-adjusted, but in general terms they are not.

Figure 1a: Borrowing and debt (market £bn)

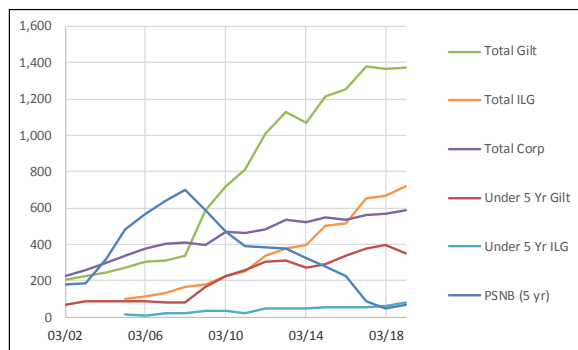
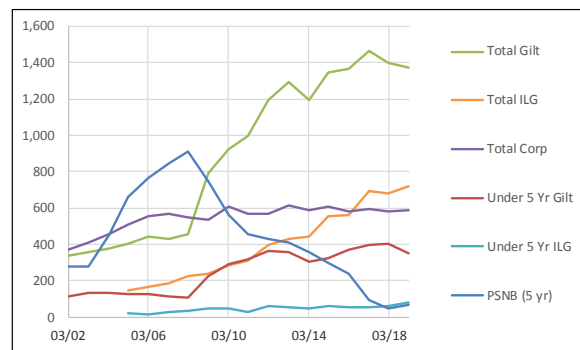


Figure 1b: Borrowing and debt (inflated to 2019 £bn)



Sources: DMO, FT, OBR

It is clear from both charts that the size of the short-dated gilt market (which won’t be capital repaid unless guaranteed austerity is on the agenda,) now swamps the future (new) borrowing requirement over the next 5 years, and that the gap has been widening since these two measures had prospective parity in 2015, as successive governments have brought new borrowing down. It is also interesting that the sterling corporate bond market has barely changed in size in real terms over the last 15 years, in spite of there being more potential demand from pension schemes. Some readers may wonder whether things would look different if the nominal value of gilts had been used instead of their market value. Back in the 2000s decade, the short answer is no. but in the 2010s, the picture has varied. There was almost no difference as recently as March 2014, but over the latest 5 years, a clear gap has arisen (due to the continued downward pressure on yields), and as at March 2019, the market values were about 16% *higher* than the nominal ones.

Since our February comment, we have had further evidence of the Pensions Regulator pushing schemes to increase their hedging ratios *regardless* of yield levels (which we find appalling, given they failed at a meeting to give any economic justification for gilt yields being where they are), and we have seen some Trustees feeling they have to increase their hedging ratios simply to avoid getting embroiled with the Regulator at a later stage. Some might claim this is to “improve member outcomes” which might be true within the pension scheme in isolation, but rather ignores the knock-on effects on reasonable employers. If they are forced to put more into pension schemes and hence less into developing or maintaining their businesses, what are the potential employment consequences for those scheme members? This is hardly improving outcomes when the wider picture is considered! But who has the clout to challenge this madness?



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 May 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	-3.0	2.3	-3.2	8.7	5.3	9.6	5.0
Overseas Equities	-2.6	4.3	5.0	15.4	12.6	13.0	6.9
US Equities	-3.2	4.8	9.4	17.3	16.0	16.8	6.3
Europe ex UK Equities	-1.4	5.2	2.4	12.1	7.2	9.3	7.2
Japan Equities	-0.9	3.1	-5.4	11.5	11.6	8.7	4.3
Pacific ex Japan Equities	-3.3	1.9	-3.1	15.1	9.6	10.5	9.2
Emerging Markets	-4.0	0.8	-3.2	15.7	8.2	8.0	9.3
UK Long-dated Gilts	4.5	7.4	6.0	6.5	9.5	8.8	6.7
UK Long-dated Corp. Bonds	1.6	5.8	6.7	6.8	7.7	9.4	6.9
UK Over 5 Yrs Index-Linked Gilts	4.6	9.7	9.3	10.3	10.0	9.5	7.3
High Yield (Global)	2.2	6.4	10.3	11.8	9.6	11.8	8.0
Overseas Bonds	5.5	8.7	9.2	6.5	6.9	4.8	5.6
Property *	0.2	0.5	5.2	6.7	9.8	10.2	8.3
Cash	0.1	0.2	0.8	0.6	0.6	0.6	2.8
Commodities £-converted	-5.1	1.2	-9.3	5.0	-8.6	-3.2	1.7
Hedge Funds original \$ basis *	1.3	3.3	1.5	5.1	3.3	5.2	6.0
Illustrative £-converted version *	1.3	4.2	7.2	9.3	8.8	6.6	7.2
Euro relative to Sterling	2.8	3.3	0.8	4.9	1.7	0.1	1.5
US \$ relative to Sterling	3.4	5.5	5.6	4.9	5.9	2.5	1.2
Japanese Yen relative to Sterling	6.1	8.2	5.6	5.7	4.5	1.2	1.7
Sterling trade weighted	-2.9	-3.6	-1.3	-4.1	-2.3	-0.6	-1.3
Price Inflation (RPI) *	1.1	1.8	3.0	3.3	2.4	3.1	2.8
Price Inflation (CPI) *	0.6	1.2	2.1	2.4	1.5	2.3	2.0
Price Inflation (RPIX) *	1.1	1.9	3.0	3.4	2.5	3.2	2.9
Earnings Inflation **	8.1	10.5	2.2	2.4	2.8	2.4	3.3
All Share Capital Growth	-3.5	0.9	-7.1	4.6	1.4	5.7	1.5
Dividend Growth	0.7	1.6	10.6	9.6	6.9	5.1	4.7
Earnings Growth	-3.4	-8.6	-23.2	27.5	-0.5	1.1	3.8

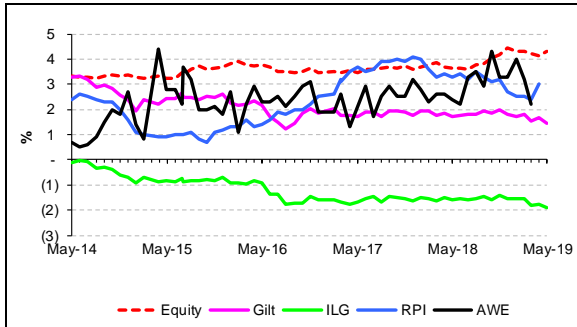
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – 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.

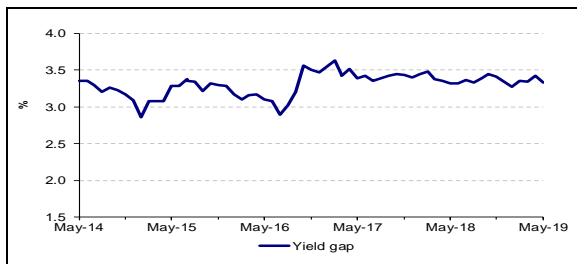


Yields and Yield Gaps

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.

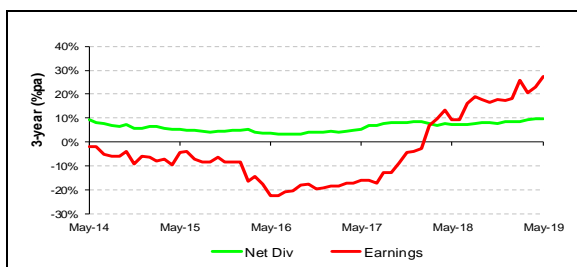
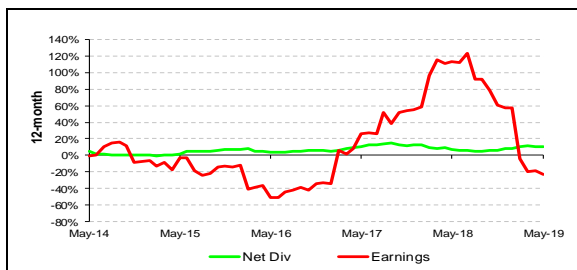


The gap gives a current expectation around 3.3% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

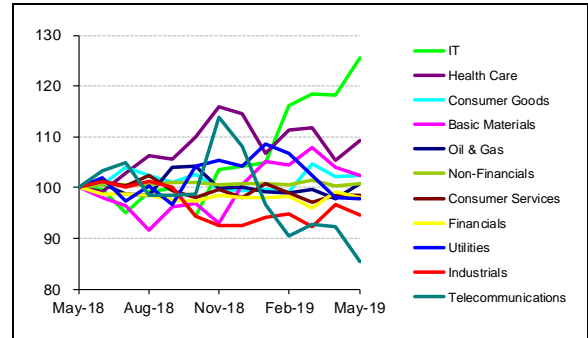
Figure 3: Dividend & Earnings Growth



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



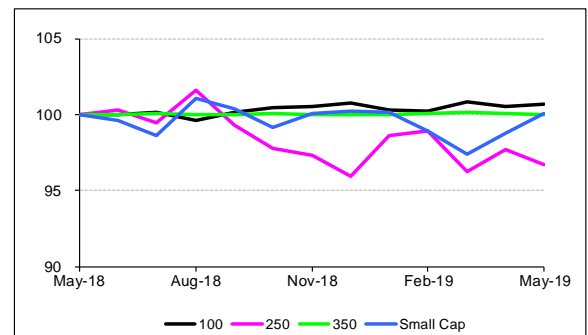
Note: Sector labels for relative lines are in end-value order

There was a slight fall this month in the rolling 12-month sector dispersion (from 42% to 40%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	0.0	4.3	-2.4
Basic Materials	-4.6	0.3	-0.9
Industrials	-5.0	2.1	-8.3
Consumer Goods	-2.8	5.7	-0.8
Health Care	0.7	0.4	5.9
Consumer Services	-3.0	1.9	-4.6
Telecommunications	-10.2	-3.6	-17.3
Utilities	-3.1	-6.2	-5.3
Non-Financials	-2.6	2.4	-2.5
Financials	-4.0	1.9	-5.1
IT	2.9	10.4	21.5
All Share	-3.0	2.3	-3.2

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid Cap fell but 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

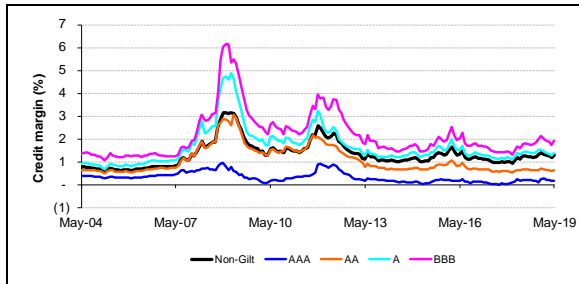


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Dec '18	2.75	1.81	0.94
Jan '19	2.55	1.71	0.84
Feb '19	2.61	1.80	0.81
Mar '19	2.34	1.54	0.80
Apr '19	2.44	1.67	0.77
May '19	2.30	1.44	0.86

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

Category	Mkt Val @ May 19 & 16, 13			Weight (%)
	May 19	May 16	May 13	
Gilts (41)	1,372	1,275	1,091	69.8
Non Gilts (1,101)	594	535	535	30.2
AAA (149)	122	104	111	6.2
AA (169)	85	96	84	4.3
A (329)	161	159	176	8.2
BBB (454)	225	176	164	11.5

Category	Mkt Val (£bn @ May 19 & 16)	W't (%)	Dur'n (yrs)
Gilts (41)	1,372 1,275	69.8	12.5
< 5 Yrs (11)	336 344	17.1	2.7
5-15 Yrs (10)	356 391	18.1	7.6
> 15 Yrs (20)	679 539	34.6	19.9
Non Gilts (1,101)	594 535	30.2	7.9
< 5 Yrs (399)	203 156	10.3	2.8
5-15 Yrs (472)	248 230	12.6	7.5
> 15 Yrs (230)	143 149	7.3	15.7

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (367)	6,438	58.7
Non Sovereigns	4,522	41.3
AAA (932)	1,282	11.7
AA (747)	1,136	10.4
A (1,036)	956	8.7
BBB (1,368)	1,148	10.5

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,100)	2,438	22.2
3 – 5 Yrs (1,164)	2,268	20.7
5 – 7 Yrs (925)	1,815	16.6
7 – 10 Yrs (773)	1,928	17.6
10+ Yrs (488)	2,511	22.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ May 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (30)	741	518	100.0	22.2
< 5 Yrs (4)	79	50	10.7	2.7
5 – 15 Yrs (8)	175	130	23.6	9.7
> 15 Yrs (18)	487	338	65.7	29.8

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

Month End	US (%)	Euro (%)	Sterling (%)
Dec '18	7.26	4.46	6.77
Jan '19	6.42	4.05	6.36
Feb '19	6.15	3.76	6.02
Mar '19	6.03	3.57	5.78
Apr '19	5.90	3.37	5.44
May '19	6.25	3.69	5.71

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

£ Gilt Market “main” Issuance

- o £3.00bn, 1% 2024 (2.40x, 0.85%, 0%, Apr '19)
 - o £4.75bn, 1⁵/₈% 2054 (**6.74x**, 1.60%, n/a, new)
 - o £1.44bn IL¹/₈% 2028 (2.39x, ry -2.33%, 15%, Oct '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.

