



Investment Headlines & Comment

- Revived hopes of a US-China trade deal lead to an equity rally (or bubble?) in several markets.
- More prospective **Euro woes**, as French and Finnish 10-year yields also turn negative.
- [Public issue](#) is coming for each pension scheme's Statement of Investment Principles.

Feature Section

This month we compare the relative profiles of the UK and US government bond markets over the last six years (being the period we have used the Financial Times as our data source - prior to that we used JP Morgan, whose monthly monitor only published up to 10-year yields, which was fair enough, given so few countries had or have ultra-long debt). Figures 1a-1d consider for the UK and the US the yield increments from 10-year debt to 30-year debt, and from 3-month LIBOR to 10-year debt. All vertical scales are the same. The charts reveal some similarities, and some differences.

Figure 1a: UK 10- and 30-yr yields (%)

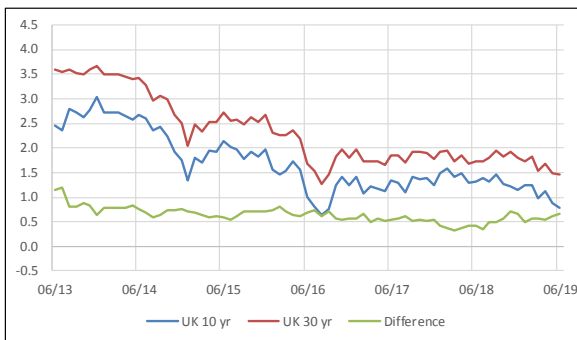


Figure 1b: UK 3-month LIBOR and 10-yr yields (%)

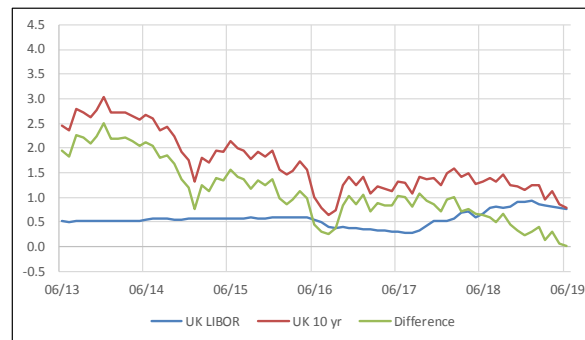


Figure 1c: US 10- and 30-yr yields (%)

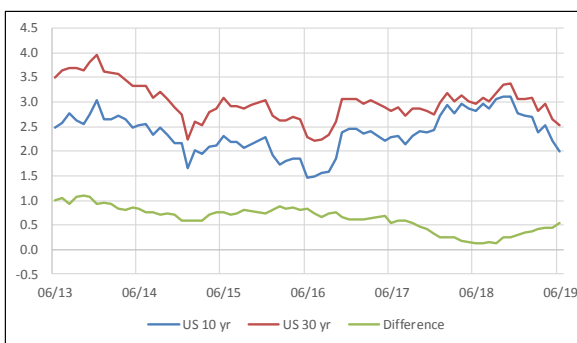
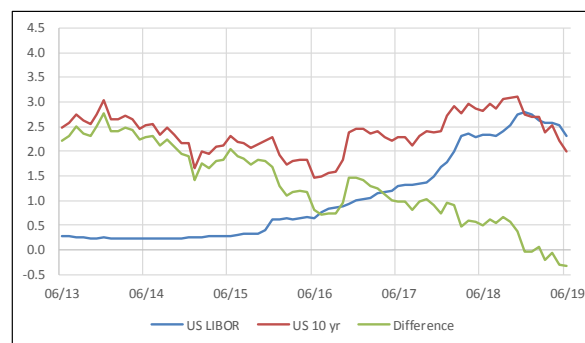


Figure 1d: US 3-month LIBOR and 10-yr yields (%)



Source: FT

For the UK, in Figure 1a, the increment between 10- and 30-year yields seems now to have settled at around 0.5%, with relatively little variation in its values. In contrast, in Figure 1c, whilst the US market's increment also seems to average around 0.5%, there is considerably more variation in the increment – 12 months ago, it was almost at the point of there being no increment at all. In absolute terms, US yields are currently slightly over 1% higher than their UK counterparts, with the most likely explanation being the pressure on UK defined benefit pension schemes to adopt gilt-led valuations with associated liability hedging (see our [May 2019](#) issue for more on this) – there is no equivalent US pressure.

The right-hand end of Figure 1d is of particular interest to many economists in that having a lower 10-year yield than current cash or short-term rates (known as an “inverted yield curve”) is sometimes thought of as an economic indicator for an impending recession. However, the negative amount currently involved for US markets looks pretty small (particularly relative to [longer-term charts](#)). Figure 1b shows that the UK is almost at the same inversion point, but with lower absolute yields, with the countries' difference for these being again slightly over 1%. It will be interesting to find out quite what happens to liability hedging if you have cash rates higher than future yields – the notion of gearing up to buy a low-return asset by borrowing a higher-cost asset is not one you would normally find in investment textbooks ...



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 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	3.7	3.3	0.6	9.0	6.3	10.3	5.1
Overseas Equities	5.6	6.4	10.6	14.3	13.7	13.9	6.8
US Equities	6.0	6.8	14.3	16.2	17.3	17.7	6.4
Europe ex UK Equities	6.4	9.1	8.6	12.9	9.0	10.5	7.1
Japan Equities	2.6	2.9	-1.2	10.2	11.4	9.0	3.9
Pacific ex Japan Equities	5.2	3.4	5.1	12.8	10.7	11.2	9.0
Emerging Markets	5.3	3.1	5.4	12.9	9.1	8.9	8.9
UK Long-dated Gilts	0.2	2.0	7.2	3.1	9.6	8.5	6.7
UK Long-dated Corp. Bonds	1.9	3.1	9.6	5.6	8.2	9.1	6.9
UK Over 5 Yrs Index-Linked Gilts	-1.0	2.0	9.1	6.0	10.1	9.2	7.3
High Yield (Global)	1.8	5.3	11.5	9.0	10.2	11.9	8.0
Overseas Bonds	1.2	6.3	9.9	2.6	7.4	5.1	5.6
Property *	0.2	0.7	4.7	6.6	9.5	10.3	8.2
Cash	0.1	0.2	0.8	0.6	0.6	0.6	2.7
Commodities £-converted	3.4	0.9	-8.2	3.2	-8.1	-2.7	1.5
Hedge Funds original \$ basis *	-1.9	0.0	-1.3	4.3	2.7	4.5	5.9
Illustrative £-converted version *	1.5	5.6	4.2	9.4	8.8	7.1	7.2
Euro relative to Sterling	1.2	3.8	1.2	2.5	2.2	0.5	1.5
US \$ relative to Sterling	-1.0	2.4	3.7	1.7	6.1	2.6	1.1
Japanese Yen relative to Sterling	-0.2	5.2	6.6	0.0	4.8	1.5	1.7
Sterling trade weighted	-0.6	-3.1	-1.7	-1.6	-2.7	-0.9	-1.2
Price Inflation (RPI) *	0.3	1.5	3.0	3.3	2.5	3.1	2.8
Price Inflation (CPI) *	0.3	1.0	2.0	2.4	1.5	2.2	2.0
Price Inflation (RPIX) *	0.3	1.5	3.0	3.4	2.5	3.2	2.9
Earnings Inflation **	-9.4	0.3	3.3	2.4	2.6	2.1	3.0
All Share Capital Growth	3.4	2.0	-3.5	4.9	2.4	6.4	1.6
Dividend Growth	-1.2	-0.2	9.5	9.2	7.3	5.4	4.7
Earnings Growth	-0.5	-2.9	-23.5	27.4	-0.6	1.6	3.9

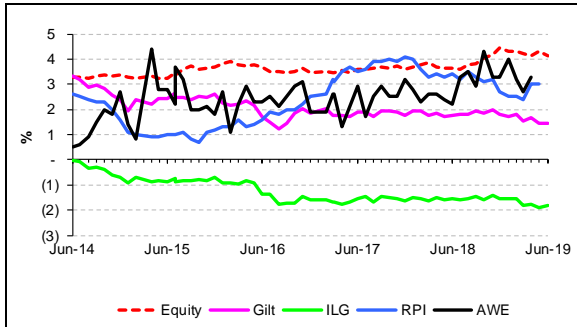
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

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

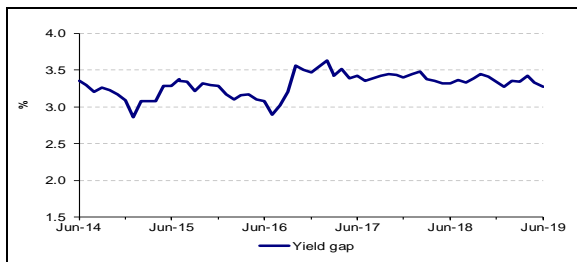


Yields and Yield Gaps

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.

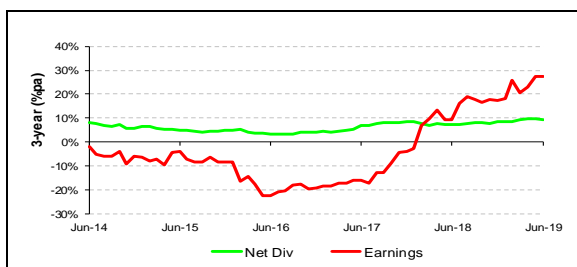
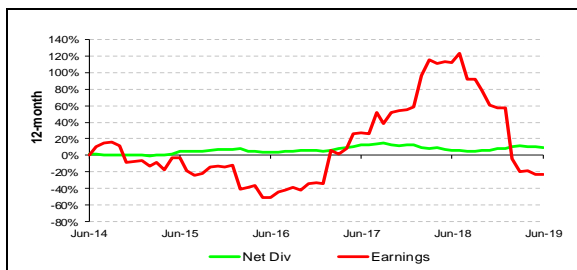


The gap gives a current expectation around 3.3% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

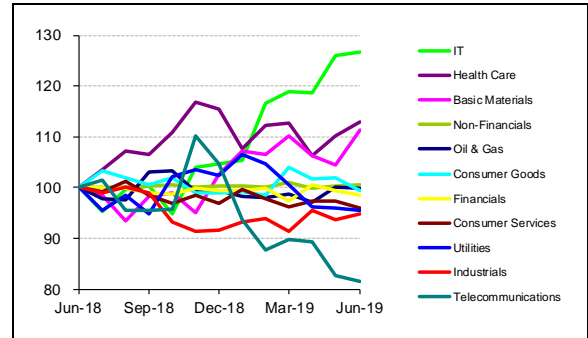
Figure 3: Dividend & Earnings Growth



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



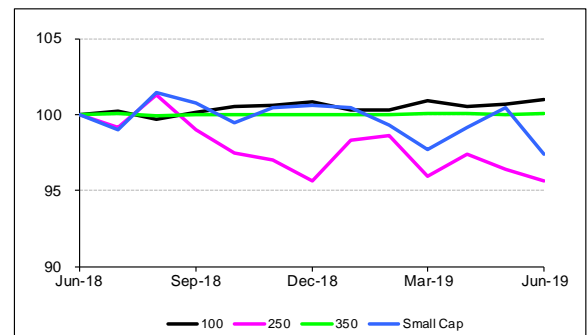
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (from 40% to 45%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	3.6	4.5	0.4
Basic Materials	10.4	4.2	11.9
Industrials	5.0	7.2	-4.6
Consumer Goods	1.2	-1.4	-0.1
Health Care	6.1	3.4	13.5
Consumer Services	2.1	3.2	-3.5
Telecommunications	2.1	-6.4	-18.1
Utilities	3.2	-1.9	-3.9
Non-Financials	4.0	2.8	1.1
Financials	2.6	4.5	-1.0
IT	4.2	9.9	27.3
All Share	3.7	3.3	0.6

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

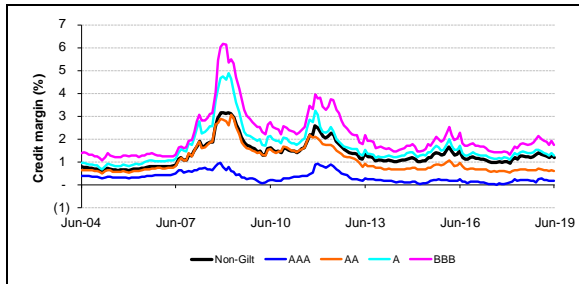


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
Jun '19	2.24	1.44	0.80

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

Category	Mkt Val @ Jun 19 & 16, 13			Weight (%)
	19	16	13	
Gilts (42)	1,375	1,357	1,066	69.4
Non Gilts (1,113)	606	547	514	30.6
AAA (151)	124	109	105	6.3
AA (172)	87	96	82	4.4
A (331)	164	163	170	8.3
BBB (459)	230	178	157	11.6

Category	Mkt Val (£bn @ Jun 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (42)	1,375	1,357	69.4	12.5
< 5 Yrs (11)	338	352	17.1	2.6
5-15 Yrs (10)	355	407	17.9	7.6
> 15 Yrs (21)	683	598	34.5	19.9
Non Gilts (1,113)	606	547	30.6	7.9
< 5 Yrs (400)	206	159	10.4	2.8
5-15 Yrs (483)	255	232	12.9	7.5
> 15 Yrs (230)	145	155	7.3	15.8

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (367)	6,602	58.8
Non Sovereigns	4,634	41.2
AAA (939)	1,302	11.6
AA (767)	1,173	10.4
A (1,048)	980	8.7
BBB (1,389)	1,179	10.5

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,110)	2,463	21.9
3 – 5 Yrs (1,205)	2,381	21.2
5 – 7 Yrs (916)	1,801	16.0
7 – 10 Yrs (779)	1,958	17.4
10+ Yrs (500)	2,633	23.4

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jun 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (30)	736	574	100.0	21.9
< 5 Yrs (4)	79	50	10.8	2.6
5 – 15 Yrs (8)	176	137	23.9	9.6
> 15 Yrs (18)	481	386	65.3	29.6

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Jun '19	5.68	3.27	5.51

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

£ Gilt Market “main” Issuance

- o £3.00bn, 1% 2024 (2.12x, 0.61%, 0%, May '19)
- o £3.16bn, 7/8% 2029 (2.10x, 0.89%, 15%, new)
- o £2.25bn, 13/4% 2049 (1.79x, 1.42%, 0%, Mar '19)
- o £0.70bn IL 1/8% 2048 (1.81x, ry -1.91%, 0%, Mar '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.

