



Investment Headlines & Comment

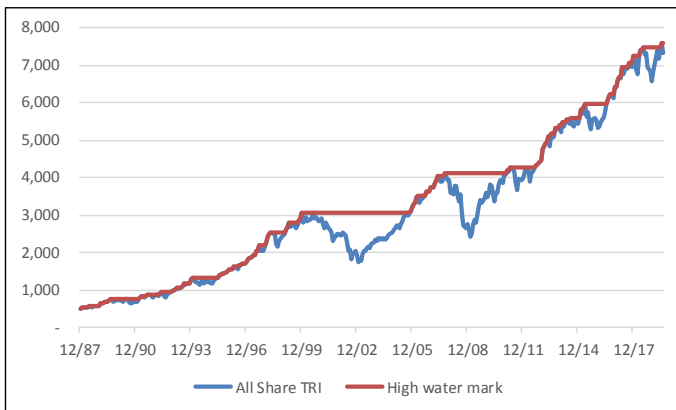
- A remarkable month for global bonds - 10-year yield drops of about 0.3% for many countries.
- Ultra-long gilt yields fell again, probably due to the Regulator’s “do LDI at any price” pressure.
- Elsewhere, 30-year German government bond yields have gone *negative* – a Euro ending?

Feature Section

This month we consider how long various markets have taken to recover from losses over time. With many occupational schemes moving more cashflow negative, going beyond just using the underlying income in their portfolio to the point of needing to realise capital from time to time, this is going to be of increasing interest. How much downside is too much?

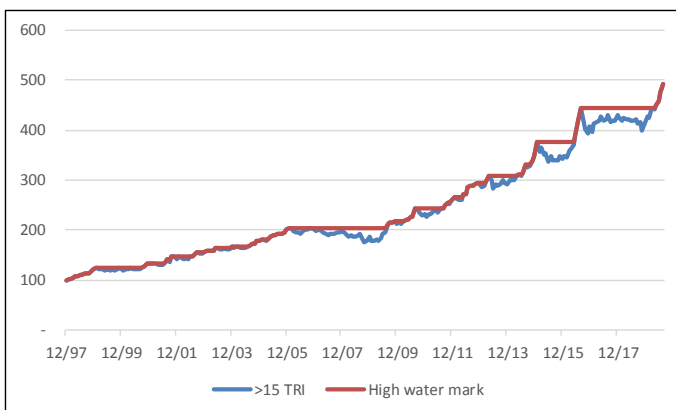
Figure 1a below shows the cumulative total return for the UK Equity market’s FTSE All Share index, together with its associated high-water-mark profile, to show the periods where disinvestments might have needed to be made during times of depressed values. We start from the end of 1987 simply because that is the longest period for which we hold monthly data. (Data sourced from FT and FTSE.) Figure 1b repeats the analysis for the iBoxx Over 15 Year Non-Gilt index, to see how that fares in comparison.

Figure 1a: UK Equity



For the UK Equity market, Figure 1a shows there have been four periods of clear drawdown: the period when the tech bubble burst (followed by the Iraq War), the credit crunch period, the 2011 Eurozone-led wobble, then the 2015 Eurozone-led wobble, and finally the 2018/19 combined effect of Brexit and Fed rates wobbles. In terms of longevity in months, they have been for 60, 39, 16, 13 and 11 months respectively.

Figure 1b: Long-dated Corporate Bonds



For the unhedged World ex UK market, there have also been five periods of clear drawdown, with their causes matching those for the UK market (apart from any Brexit effect in the last one). In terms of longevity, measured in months, they have been for 79, 28, 16, 12 and 6 months respectively.

Figure 1b shows the analysis for the iBoxx long-dated UK Corporate Bond market, but starts later, from the end of 1997, given the index only started then. The market had a 20-month drawdown period across 1999-2000, a 33-month one across 2007-09, and has recently finished a 32-month one begun in mid 2016.

Whilst some of the periods overlap across asset classes, we find it difficult to construct an economic scenario where all asset values would be depressed for a prolonged period. So, at a time when the gilt market is of questionable valuation (other than to behavior-led investors), a diversified portfolio of assets with steady disinvestments made across them on a regular basis looks a considerably better bet than overpaying for (or even gearing up for) an asset just because it has a guaranteed payment pattern.

There is also the point that cashflow negative pension schemes may wish to disinvest a year or more’s net outgo from an asset after any sharp appreciation to an all-time high (but not necessarily if the growth is slow).



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 August 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	-3.6	2.0	0.4	6.3	5.6	8.4	5.0
Overseas Equities	-1.7	8.3	7.2	12.7	13.4	12.7	7.1
US Equities	-1.2	10.5	9.7	15.5	17.0	16.7	6.4
Europe ex UK Equities	-1.5	7.0	5.6	10.5	9.5	8.6	7.6
Japan Equities	-0.6	6.2	0.2	8.3	11.9	8.4	3.5
Pacific ex Japan Equities	-3.8	3.7	1.7	8.8	8.8	9.7	9.2
Emerging Markets	-4.3	3.5	2.5	8.8	7.2	7.5	8.9
UK Long-dated Gilts	6.6	10.1	18.5	3.3	9.8	8.9	7.1
UK Long-dated Corp. Bonds	4.0	9.7	16.8	3.5	8.4	8.8	7.2
UK Over 5 Yrs Index-Linked Gilts	5.1	8.1	19.4	5.2	10.5	9.9	7.9
High Yield (Global)	0.4	6.5	13.4	8.3	10.7	11.3	8.4
Overseas Bonds	3.5	8.5	16.6	4.5	8.4	5.4	6.0
Property *	0.2	0.6	3.6	7.5	8.8	10.3	8.1
Cash	0.1	0.2	0.8	0.6	0.6	0.6	2.7
Commodities £-converted	-5.1	1.8	-8.8	4.8	-7.6	-2.8	1.0
Hedge Funds original \$ basis *	0.5	0.9	1.4	4.5	3.2	4.5	5.8
Illustrative £-converted version *	4.5	7.4	8.6	7.3	10.0	7.7	7.3
Euro relative to Sterling	-0.5	2.3	1.0	2.1	2.7	0.3	1.6
US \$ relative to Sterling	0.6	3.5	6.7	2.5	6.4	3.0	1.4
Japanese Yen relative to Sterling	2.8	5.9	11.5	1.6	5.9	1.6	1.6
Sterling trade weighted	0.7	-2.3	-2.9	-1.4	-2.9	-0.8	-1.3
Price Inflation (RPI) *	0.0	0.5	2.8	3.2	2.5	3.1	2.8
Price Inflation (CPI) *	0.0	0.3	2.0	2.4	1.6	2.2	2.1
Price Inflation (RPIX) *	0.0	0.5	2.7	3.3	2.6	3.2	2.9
Earnings Inflation **	0.6	-8.9	3.6	2.8	2.6	2.1	3.0
All Share Capital Growth	-4.4	0.7	-3.7	2.3	1.7	4.6	1.5
Dividend Growth	1.5	0.5	9.8	9.4	7.6	6.9	4.7
Earnings Growth	2.7	4.7	-22.0	31.5	-0.1	5.1	4.2

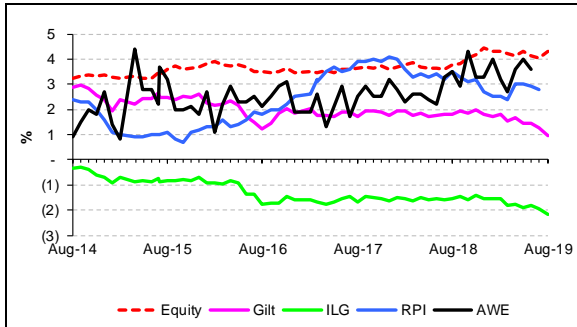
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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.

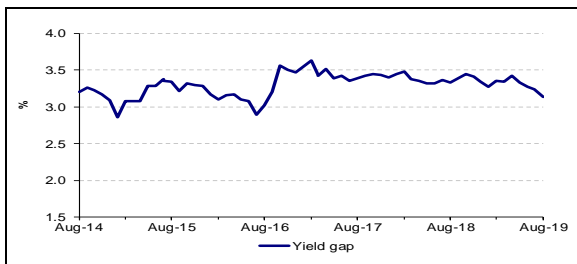


Yields and Yield Gaps

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.

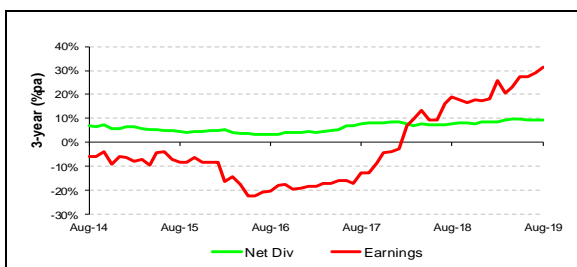
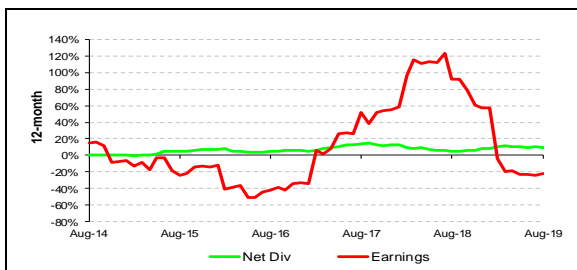


The gap gives a current expectation around 3.1% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

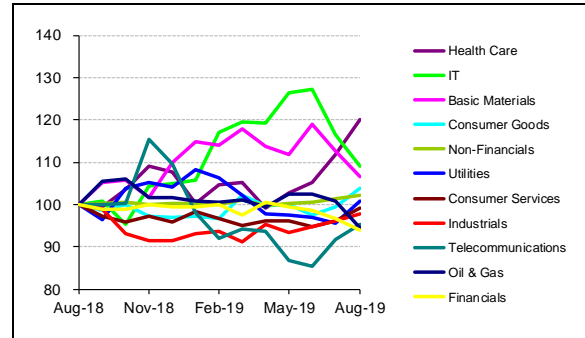
Figure 3: Dividend & Earnings Growth



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



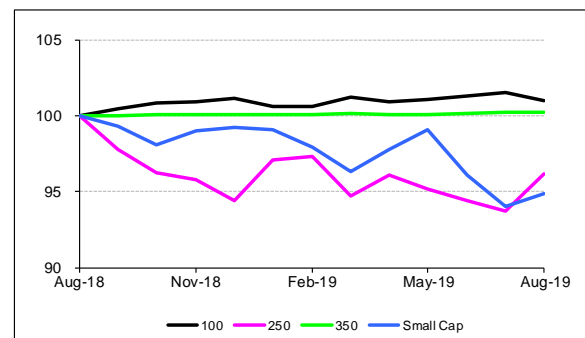
Note: Sector labels for relative lines are in end-value order

There was a marked fall this month in the rolling 12-month sector dispersion (from 35% to 26%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-9.7	-6.0	-5.2
Basic Materials	-8.6	-2.7	7.1
Industrials	-1.8	6.6	-1.8
Consumer Goods	0.7	5.9	4.2
Health Care	3.4	19.0	20.5
Consumer Services	-0.6	5.1	-0.4
Telecommunications	0.1	12.1	-4.4
Utilities	1.7	5.3	1.1
Non-Financials	-2.6	4.0	2.6
Financials	-6.2	-3.7	-5.6
IT	-9.9	-12.2	9.4
All Share	-3.6	2.0	0.4

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

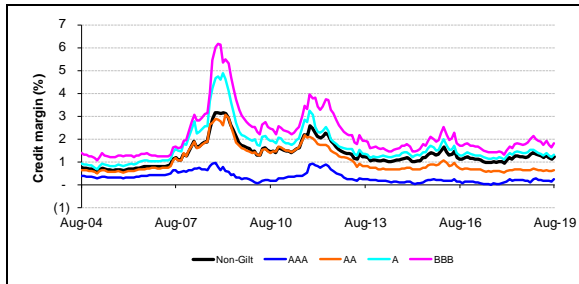


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
Jul '19	2.08	1.27	0.81
Aug '19	1.80	0.97	0.83

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

Category	Mkt Val @ Aug 19 & 16, 13			Weight (%)
	Aug 19	Aug 16	Aug 13	
Gilts (43)	1,438	1,452	1,084	69.3
Non Gilts (1,129)	637	584	518	30.7
AAA (151)	129	114	106	6.2
AA (168)	87	99	83	4.2
A (341)	178	181	167	8.6
BBB (469)	244	191	161	11.7

Category	Mkt Val (£bn @ Aug 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (43)	1,438	1,452	69.3	13.2
< 5 Yrs (10)	310	395	14.9	2.6
5-15 Yrs (12)	376	391	18.1	7.5
> 15 Yrs (21)	753	665	36.3	20.5
Non Gilts (1,129)	637	584	30.7	8.1
< 5 Yrs (398)	207	168	10.0	2.7
5-15 Yrs (500)	276	241	13.3	7.5
> 15 Yrs (231)	155	176	7.5	16.3

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (365)	6,891	58.9
Non Sovereigns	4,800	41.1
AAA (952)	1,333	11.4
AA (766)	1,211	10.4
A (1,083)	1,020	8.7
BBB (1,440)	1,237	10.6

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,117)	2,430	20.8
3 – 5 Yrs (1,252)	2,464	21.1
5 – 7 Yrs (922)	1,894	16.2
7 – 10 Yrs (792)	1,984	17.0
10+ Yrs (523)	2,919	25.0

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Aug 19 & 16)		W't (%)	Dur'n (yrs)
Gilts (30)	801	645	100.0	22.3
< 5 Yrs (5)	106	51	13.2	3.0
5 – 15 Yrs (7)	160	146	20.0	10.3
> 15 Yrs (18)	535	448	66.8	29.7

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Jul '19	5.66	3.22	5.57
Aug '19	5.60	3.10	5.52

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

£ Gilt Market “main” Issuance

- o £3.00bn, 5/8% 2025 (2.14x, 0.37%, 0%, Jul 19)
- o £0.50bn, 4 1/4% 2046 (2.54x, 1.02%, n/a, Jun 16)
- o £2.30bn, 1 3/4% 2049 (2.02x, 1.15%, 15%, Jun 19)
- o £1.26bn IL 1/8% 2028 (2.29x, ry -2.99%, 15%, May 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.

