



Investment Update January 2020

Investment Headlines & Comment

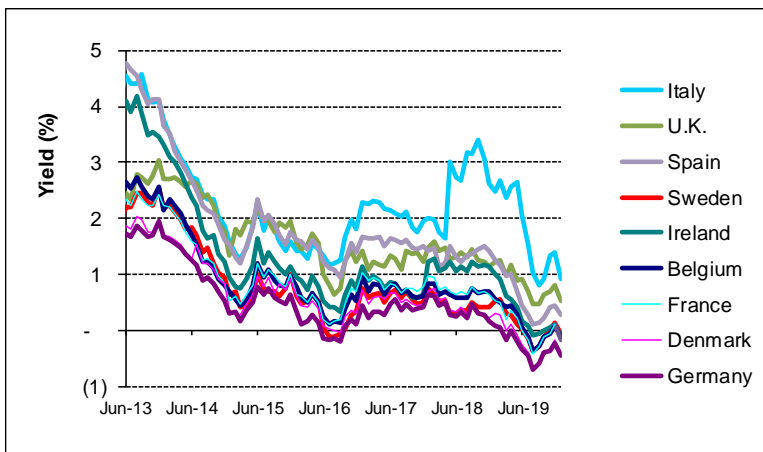
- China's Coronavirus has hit commodity prices hard.
- The UK Equity Oil and Materials sectors also fell.
- A strong month for gilts and corporate bonds.

Feature Section

This month we provide an update on 10- and 30-year bond yields across the major government bond markets. We last looked at this in our [July 2016](#) issue.

Figure 1a below shows the movements in 10-year European bond yields over the period since mid-2013. The dispersion of yields continues, with Italy over 1.3% higher than Germany (and Spain over 0.7% higher), and yet the Euro soldiers on, political will prevailing over economic considerations. How the UK fares outside the EU could have a bearing on whether that changes (e.g. if a Euro country such as Italy heads for the exit). At their current 0.5%, UK 10-year yields are now about 1% below the yields on comparable US government debt. It also appears that the markets are pricing in some further rate cuts (perhaps fearing the worst for the post-EU UK), and also that any eventual rise in cash rates is going to be pretty limited in the next few years.

Figure 1a: 10-year yields



The UK is no longer the world's 3rd largest government bond market (France and Italy have overtaken us). However, the UK market is still the most skewed to the long end – for example, the duration (weighted average term) of UK gilts is about 13.5 years, compared with 7 years for the US and 11 years for Japan (these being the largest and second largest government bond markets, respectively). The US market is now over 6 times and the Japanese market is just over 3 times the size of the UK market.

Figure 1b: 30-year yields

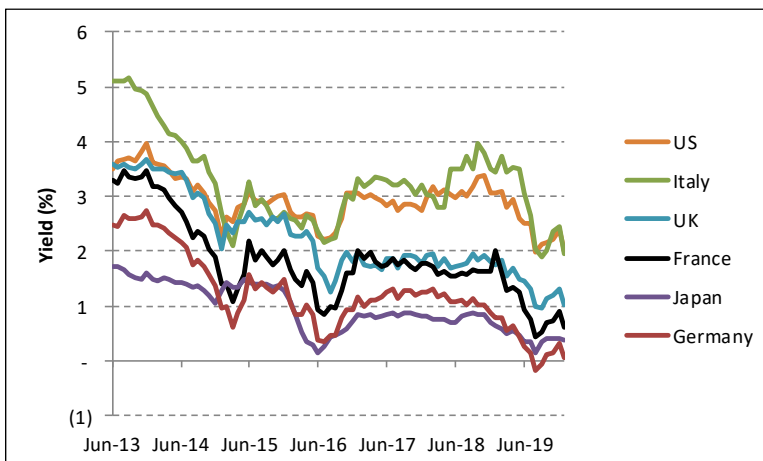


Figure 1b shows that there have been some pretty significant shifts in long-dated yields over the period. The question remains of whether central Eurozone governments are near to bust, yet cannot bring themselves to nudge some taxes up in a bid to get things in line – the current 30-year yields of 0.06% for Germany and 0.60% for France are quite remarkable, and suggest severe trouble ahead.

Figure 1b shows that long-dated US and UK yields have remained decoupled over the last 3 years or so (and long-dated US real yields remain well ahead of those in the UK). The distortions from some price-insensitive UK institutional investors remain evident.

Sources: FT, JP Morgan, labels in end value order.

Notes: In Figure 1b, the FT's Japan data is 20 year for 2013 and 2014, but they switch to 30-year for 2015.



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 2020

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	-3.2	2.2	10.7	5.8	6.3	8.2	5.1
Overseas Equities	-0.5	3.1	16.8	10.1	12.4	12.2	6.7
US Equities	0.7	5.1	21.8	12.9	15.3	16.2	6.0
Europe ex UK Equities	-1.6	1.0	15.4	8.0	9.2	8.3	7.5
Japan Equities	-1.2	-0.8	10.5	5.6	10.2	8.8	2.7
Pacific ex Japan Equities	-3.2	0.4	6.9	6.5	8.0	8.5	8.9
Emerging Markets	-4.2	0.5	4.0	6.6	7.6	6.2	7.9
UK Long-dated Gilts	6.3	2.4	16.6	8.4	6.1	9.3	7.1
UK Long-dated Corp. Bonds	5.9	4.8	20.1	8.9	6.3	9.0	7.5
UK Over 5 Yrs Index-Linked Gilts	4.7	0.7	11.0	4.5	6.5	9.0	7.4
High Yield (Global)	0.6	0.7	9.2	4.4	8.9	9.2	8.2
Overseas Bonds	2.2	-1.3	6.0	2.5	5.3	4.2	5.7
Property *	0.1	0.3	2.1	6.9	7.4	9.2	7.8
Cash	0.1	0.2	0.8	0.6	0.6	0.6	2.6
Commodities £-converted	-10.4	-6.4	-4.0	-2.5	-2.5	-3.9	-0.2
Hedge Funds original \$ basis *	1.8	3.5	10.4	4.5	3.6	4.1	5.2
Illustrative £-converted version *	-0.6	-3.7	6.1	2.1	7.0	6.1	6.3
Euro relative to Sterling	-0.8	-2.5	-3.6	-0.7	2.3	-0.3	1.7
US \$ relative to Sterling	0.5	-1.8	-0.2	-1.5	2.6	2.0	1.0
Japanese Yen relative to Sterling	0.8	-2.1	0.2	-0.3	4.3	0.2	1.0
Sterling trade weighted	0.7	2.2	2.9	1.5	-1.7	0.0	-1.2
Price Inflation (RPI) *	0.3	0.3	2.2	3.0	2.5	3.0	2.8
Price Inflation (CPI) *	0.0	0.0	1.3	2.1	1.6	2.1	2.0
Price Inflation (RPIX) *	0.3	0.3	2.2	3.0	2.6	3.0	2.9
Earnings Inflation **	-0.1	0.4	3.3	3.0	2.9	2.2	2.9
All Share Capital Growth	-3.3	1.6	6.1	1.7	2.3	4.3	1.6
Dividend Growth	0.2	0.4	4.8	8.5	7.6	6.8	4.7
Earnings Growth	0.2	-4.0	-25.2	23.0	1.5	5.1	3.8

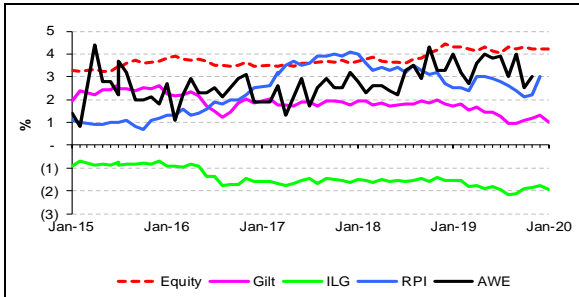
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – 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.

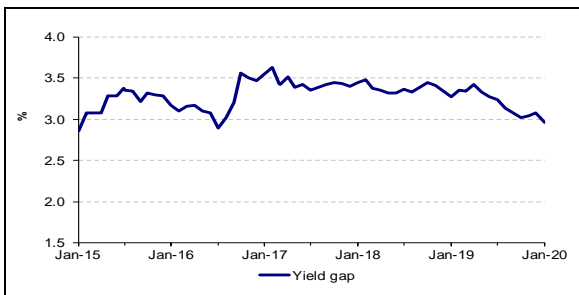


Yields and Yield Gaps

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.

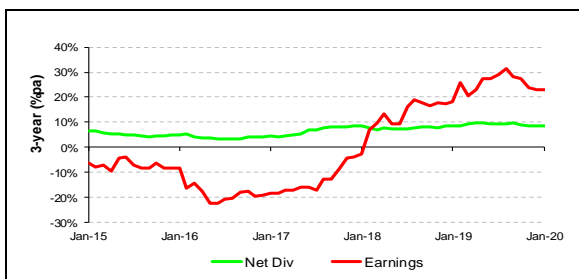
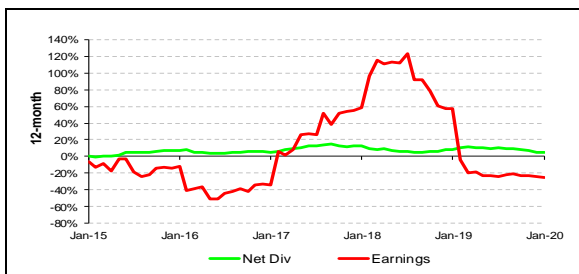


The gap gives a current expectation around 3.0% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

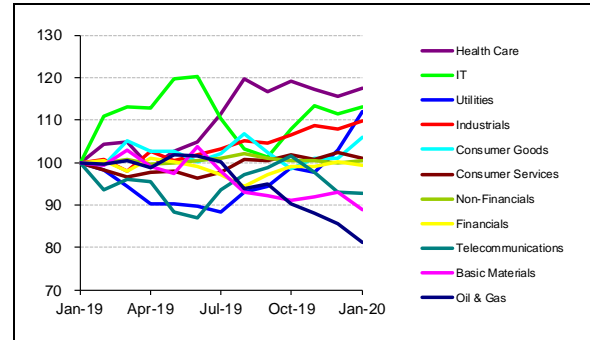
Figure 3: Dividend & Earnings Growth



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



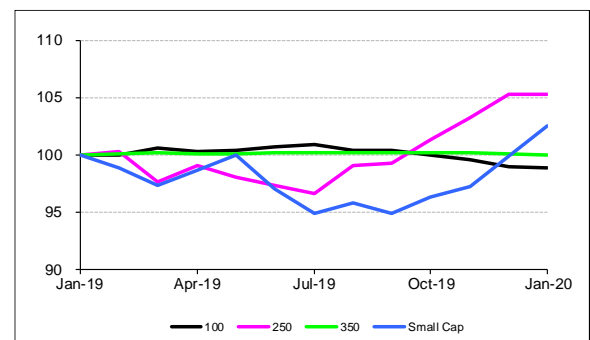
Note: Sector labels for relative lines are in end-value order

There was a rise this month in the rolling 12-month sector dispersion (from 29% to 36%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-8.2	-8.1	-10.1
Basic Materials	-7.5	-0.1	-1.6
Industrials	-1.7	5.3	21.4
Consumer Goods	1.6	9.9	17.2
Health Care	-1.4	0.9	30.1
Consumer Services	-4.4	1.5	11.8
Telecommunications	-3.6	-6.7	2.6
Utilities	5.2	15.8	23.9
Non-Financials	-2.9	2.1	11.0
Financials	-4.1	2.4	9.8
IT	-1.8	7.3	25.2
All Share	-3.2	2.2	10.7

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Small Cap rose in relative terms this month, but Mid Cap was flat in relative terms.

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



Bond market information

Figure 5: £ Non-Gilt Credit Margins

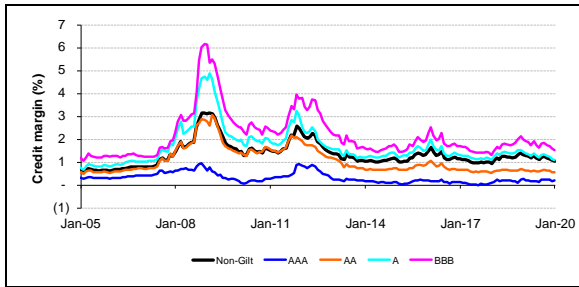


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
Aug '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
Dec '19	1.99	1.30	0.69
Jan '20	1.66	1.00	0.66

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

Category	Mkt Val @ Jan 20 & 17, 14			Weight (%)
	Jan 20	Jan 17	Jan 14	
Gilts (42)	1,440	1,322	1,091	68.9
Non Gilts (1,149)	650	539	518	31.1
AAA (154)	131	103	99	6.3
AA (167)	87	85	87	4.2
A (349)	182	168	165	8.7
BBB (479)	250	183	167	12.0

Category	Mkt Val (£bn @ Jan 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (42)	1,440	1,322	68.9	13.2
< 5 Yrs (10)	310	376	14.8	2.6
5-15 Yrs (12)	418	360	20.0	7.8
> 15 Yrs (20)	712	586	34.1	20.9
Non Gilts (1,149)	650	539	31.1	8.1
< 5 Yrs (409)	213	153	10.2	2.7
5-15 Yrs (509)	279	234	13.3	7.4
> 15 Yrs (231)	159	152	7.6	16.5

Tables 2d, 2e: € Market Size and Maturity (Jan 20)

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (362)	6,803	58.5
Non Sovereigns	4,823	41.5
AAA (955)	1,301	11.2
AA (766)	1,180	10.1
A (1,153)	1,063	9.1
BBB (1,536)	1,279	11.0

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,139)	2,463	21.2
3 – 5 Yrs (1,270)	2,403	20.7
5 – 7 Yrs (961)	1,895	16.3
7 – 10 Yrs (833)	1,974	17.0
10+ Yrs (569)	2,891	24.9

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Jan 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (29)	760	618	100.0	21.8
< 5 Yrs (4)	94	34	12.3	2.8
5 – 15 Yrs (8)	183	145	24.1	10.4
> 15 Yrs (17)	483	438	63.6	29.8

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

Month End	US (%)	Euro (%)	Sterling (%)
Sept '19	5.49	3.11	5.48
Oct '19	5.54	3.17	5.38
Nov '19	5.45	3.08	5.25
Dec '19	5.15	2.92	4.94
Jan '20	5.23	2.90	4.84

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

£ Gilt Market “main” Issuance

- £3.25bn, ⁵/₈% 2025 (2.15x, 0.54%, 0%, Nov 19)
- £3.16bn, ⁷/₈% 2029 (2.49x, 0.79%, 15%, Dec 19)
- £2.75bn, ⁷/₈% 2029 (2.31x, 0.50%, 0%, Jan 20)
- £2.55bn, 1¼% 2041 (2.18x, 1.16%, 13%, Nov 19)
- £1.06bn IL¹/₈% 2028 (2.59x, ry -2.44%, 6%, Oct 19)
- £0.25bn IL¹/₈% 2048 (3.44x, ry -1.96%, n/a, Dec 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.

