

Investment Update March 2020



Investment Headlines & Comment

- A month like no other, as initially there was a Russia / OPEC oil dispute, but then the Covid-19 virus took a hold on life globally in ways nobody has ever seen before. Financial markets were duly badly affected, in what now looks to have been the fastest bear market ever.
- The UK base rate was cut twice, from 0.75% to 0.25% and then to 0.1%. It is debatable how much difference those moves would make, when the % levels involved are so small.
- There was significant reintroduction of Quantitative Easing (QE) with the previous level of £435bn being replaced by a new target portfolio of £645bn. However, just how damaging will be the resulting distortion of the gilt market? Will any of the gilts ever get sold back into the wider market?
- Sterling had a poor month. In trade-weighted terms it fell back to levels last seen in Q3 2019.
- Equity volatility measures have spiked out, such as the [VIX](#) measure, but it has not (yet) reached the levels seen in the 2008 financial crisis.
- Long dated gilts and index-linked gilts (ILGs) became incredibly volatile – for example, the Over 15 Year ILG index fell by over 8% *in one day* on 18 March, then rallied by over 12% on 20 March, and by over 8% on 23 March.
- This is even more bizarre when you think about the way that future expectations of inflation have fallen (see p3) – possibly the result of pension fund LDI strategies applying triggers based on out-of-date analysis?
- Credit spreads on corporate bonds moved out to 2%, which is high, but well short of the levels seen in the “credit crunch”.
- Sub investment grade bond yields jumped up by 2.5%-3% in just one month. Even for short-dated portfolios, this still creates a double-digit loss.
- Commercial Property valuers have introduced a “Market Valuation Uncertainty” clause, and many funds have suspended trading as a result (but not necessarily as a result of their having any liquidity issues).
- The Government’s decision to cover a material element of employee wages will lead to a major increase in borrowing, which would ordinarily push up gilt yields. Will pension fund LDI appetite be enough to absorb this, or will they start to see severe losses on those portfolios? Or will QE be the support mechanism here?
- Within the Commodities sector, the oil price fell by over 65% during Q1 2020. There is concern it may fall further as storage of over-supply becomes an increasing problem.
- Initial falls in even defensive assets suggested signs of forced selling by leveraged investors / hedge funds to cover their positions, but this seems to have eased as the month drew to a close.

Feature Section

This month, there is not really space for a proper column, and in view of all the news above, if there was one, it would probably just add to the general atmosphere of gloom. So, instead, we focus on a couple of observations, arguably somewhere between humorous and witheringly accurate in current times.

First, the author Jean-Paul Kauffmann, who observed “*the economy depends about as much on economists as the weather does on weather forecasters*”. Given the unprecedented “shut the economy” measures this month, this statement may get amply demonstrated over the next few months. The “noise level” from managers in e-mails and webinars this month has been unprecedented, and so have some of their losses.

Second, JP Getty, who helpfully observed “*If you owe the bank \$100 that’s your problem. If you owe the bank \$100 million, that’s the bank’s problem*”. It remains to be seen whether the banks recognize their past bailing out, and thus try to do the right thing for individuals and employers, particularly how inevitable it seems that large numbers of people will still not be covered by the Government’s financial support schemes.



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 March 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	-15.1	-25.1	-18.5	-4.2	0.6	4.4	3.5
Overseas Equities	-10.7	-15.5	-5.5	2.6	7.6	8.9	5.4
US Equities	-10.0	-14.1	-2.3	5.4	10.5	12.7	4.6
Europe ex UK Equities	-11.7	-18.0	-8.0	-0.4	4.0	5.3	6.2
Japan Equities	-3.7	-11.0	-2.1	1.4	6.0	6.4	1.9
Pacific ex Japan Equities	-11.8	-15.8	-11.2	-0.7	4.3	5.5	8.0
Emerging Markets	-12.8	-18.3	-13.2	-1.0	3.7	3.1	6.8
UK Long-dated Gilts	2.5	11.2	17.6	8.0	8.0	9.9	7.2
UK Long-dated Corp. Bonds	-9.2	-4.8	3.6	3.5	4.8	7.7	6.8
UK Over 5 Yrs Index-Linked Gilts	-4.6	1.9	2.4	2.9	6.3	8.5	7.1
High Yield (Global)	-10.2	-8.2	-3.6	0.6	6.4	7.3	7.7
Overseas Bonds	3.2	10.4	13.0	4.9	7.1	4.5	5.9
Property *	0.3	0.6	2.3	6.6	7.1	8.8	7.7
Cash	0.1	0.2	0.8	0.7	0.6	0.6	2.6
Commodities £-converted	-27.3	-38.4	-38.0	-13.1	-9.6	-8.6	-2.4
Hedge Funds original \$ basis *	-2.2	-0.7	2.7	2.9	2.7	3.8	4.7
Illustrative £-converted version *	1.0	0.5	6.9	2.0	6.6	5.6	5.9
Euro relative to Sterling	2.9	4.4	2.7	1.1	4.1	-0.1	2.0
US \$ relative to Sterling	3.0	6.8	5.1	0.3	3.7	2.0	1.3
Japanese Yen relative to Sterling	2.9	7.6	7.7	1.3	5.9	0.6	1.0
Sterling trade weighted	-2.1	-3.6	-2.1	0.1	-2.7	-0.1	-1.4
Price Inflation (RPI) *	0.5	0.3	2.5	2.8	2.6	2.9	2.8
Price Inflation (CPI) *	0.4	0.1	1.7	2.1	1.8	2.1	2.1
Price Inflation (RPIX) *	0.5	0.4	2.5	2.9	2.7	3.0	2.9
Earnings Inflation **	0.8	3.4	3.2	3.4	2.9	2.2	2.9
All Share Capital Growth	-15.4	-26.0	-21.9	-8.0	-3.2	0.7	0.0
Dividend Growth	-0.5	0.1	2.4	7.5	7.1	6.5	4.9
Earnings Growth	0.6	3.8	1.4	20.6	1.6	4.1	3.9

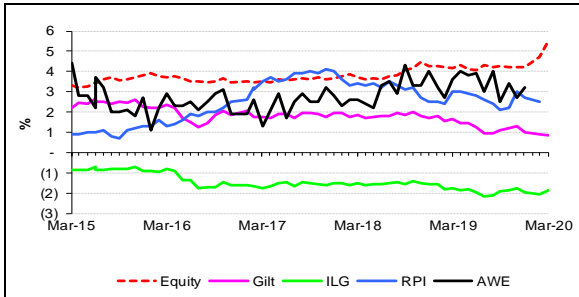
Note: All market returns are total returns for pension funds with income reinvested monthly. Indices used are as follows:

- 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 – ICE 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.

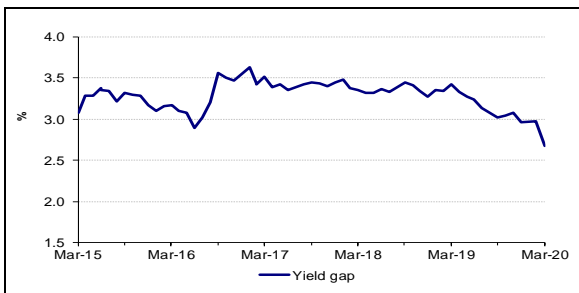


Yields and Yield Gaps

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.

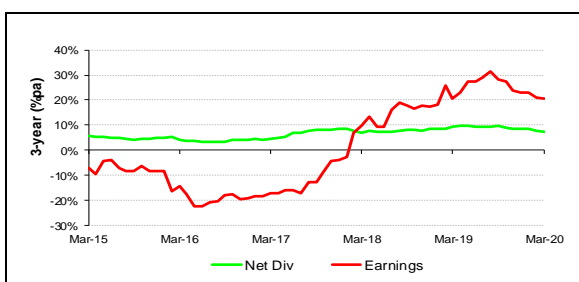
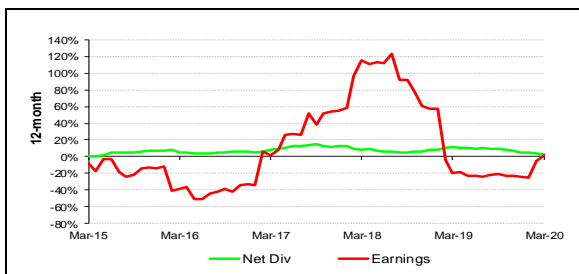


The gap gives a current expectation around 2.7% for longer-term inflation including the risk premium for gilts, relative to index-linked gilts.

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]

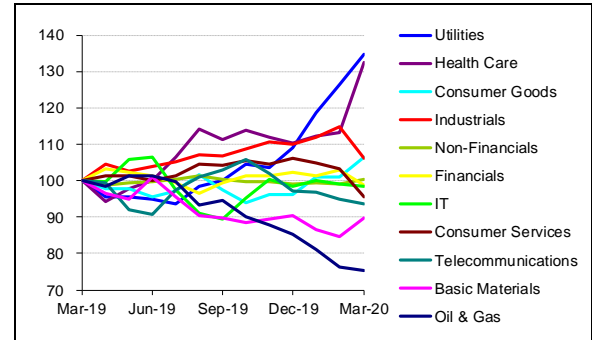
Figure 3: Dividend & Earnings Growth



Note: Earnings data from mid-2015 onwards is no longer reliable as one-off events may be affecting the prospective P/E ratios

UK Equity Sector Returns

Figure 4a: Sectors relative to All Share



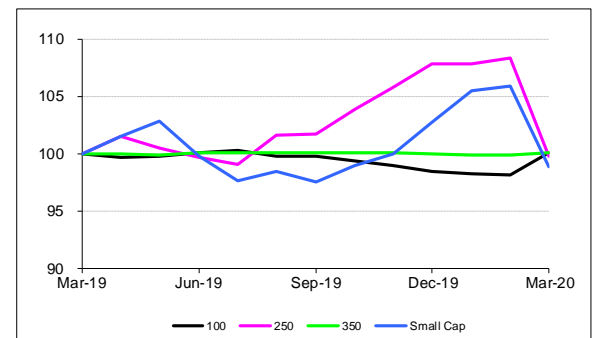
Note: Sector labels for relative lines are in end-value order

There was a sharp rise this month in the rolling 12-month sector dispersion (from 44% to 59%).

(% absolute return)	1 mth	3 mth	12 mth
Oil & Gas	-16.2	-33.9	-38.6
Basic Materials	-9.9	-25.7	-26.7
Industrials	-21.4	-27.8	-13.4
Consumer Goods	-10.5	-17.1	-13.2
Health Care	-0.6	-10.1	7.9
Consumer Services	-21.4	-32.5	-22.0
Telecommunications	-16.1	-27.7	-23.6
Utilities	-9.3	-7.5	9.9
Non-Financials	-13.8	-24.2	-18.1
Financials	-18.6	-27.8	-19.5
IT	-15.8	-25.3	-19.8
All Share	-15.1	-25.1	-18.5

UK Equity Size Returns

Figure 4b: Size groups relative to All Share



Mid and Small Cap both fell sharply 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

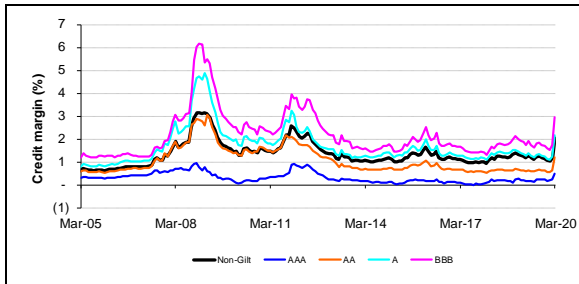


Table 2a: Over 15 Yr Corporate Yields & Margins

Month End	iBoxx Corp AA Y'ld (%)	FT 20 yr Gilt (%)	Margin (%)
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
Feb '20	1.69	0.91	0.78
Mar '20	2.30	0.83	1.47

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

Category	Mkt Val @ Mar 20 & 17, 14			Weight (%)
	20	17	14	
Gilts (42)	1,467	1,382	1,070	70.0
Non-Gilts (1,177)	629	559	524	30.0
AAA (162)	138	108	100	6.6
AA (164)	83	88	86	4.0
A (364)	177	169	169	8.4
BBB (487)	230	193	169	11.0

Category	Mkt Val (£bn @ Mar 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (42)	1,467	1,382	70.0	13.7
< 5 Yrs (9)	277	377	13.2	2.6
5-15 Yrs (12)	439	377	20.9	7.7
> 15 Yrs (21)	751	628	35.8	21.2
Non-Gilts (1,177)	629	559	30.0	7.7
< 5 Yrs (425)	217	163	10.3	2.7
5-15 Yrs (521)	270	239	12.9	7.3
> 15 Yrs (231)	142	157	6.8	15.9

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

Category	Mkt Val (€bn)	Weight (%)
Sovereigns (374)	6,758	59.2
Non-Sovereigns	4,651	40.8
AAA (971)	1,301	11.4
AA (770)	1,150	10.1
A (1,207)	1,036	9.1
BBB (1,537)	1,164	10.2

Category	Mkt Val (€bn)	Weight (%)
1 – 3 Yrs (1,153)	2,447	21.4
3 – 5 Yrs (1,288)	2,347	20.6
5 – 7 Yrs (963)	1,852	16.2
7 – 10 Yrs (846)	1,912	16.8
10+ Yrs (609)	2,850	25.0

Table 2f: Breakdown of £ Index-Linked Market

Category (Number of issues)	Mkt Val (£bn @ Mar 20 & 17)		W't (%)	Dur'n (yrs)
Gilts (29)	745	653	100.0	21.4
< 5 Yrs (4)	93	53	12.5	2.7
5 – 15 Yrs (8)	184	138	24.7	10.3
> 15 Yrs (17)	467	463	62.8	29.5

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

Month End	US (%)	Euro (%)	Sterling (%)
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
Feb '20	5.64	3.29	5.15
Mar '20	8.26	6.51	8.75

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

£ Gilt Market “main” Issuance

- £3.50bn, ⁵/₈% 2025 (1.75x, 0.22%, 0%, Jan 20)
- £3.25bn, ⁵/₈% 2025 (1.97x, 0.64%, 0%, Mar 20)
- £2.59bn, 4¾% 2030 (2.23x, 0.31%, 15%, May 15)
- £2.30bn, 1¾% 2049 (2.12x, 1.03%, 15%, Dec 19)
- £1.24bn IL ¹/₈% 2028 (2.51x, ry -2.73%, 13%, Jan 20)

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. No PAOF applies for tender or syndication cases.

